

REVENUE & TAXATION POLICY COMMITTEE
Thursday, June 14, 2012
10:00 a.m. – 3:00 p.m.
Sacramento Convention Center, 1400 J Street, Rm. 204, Sacramento

Special Order of Business
Post Redevelopment & State Budget Update
10:00 a.m., Room 204, Sacramento Convention Center

Individuals who wish to review the full text of bills included in this packet are encouraged to do so by visiting the League's Web site at www.cacities.org/billsearch. Be sure to review the most recent version of the bill.

A G E N D A

- I. Welcome and Introductions**
- II. Public Comment**
- III. Continuation of State Budget Discussion, If Necessary—Michael Coleman and Dan Carrigg**
- IV. Legislative Update**
1. Policy Discussion: Amazon Warehouse Location: Impact of Local Sales Tax Agreements (*Attachment A*) *Action*
 2. SB 1151 and SB 1156 (Steinberg) Post-Redevelopment Legislation (*Attachment B*) *Action*
- V. Cap and Trade Auction Proceeds Discussion (*Attachment C*)** *Action*
- VI. Federal Update:**
1. Status of Use Tax Collection Measures *Informational*
 2. Other Federal Fiscal Legislation *Informational*
- VII. June Ballot: Trends in Local Revenue Measures—Michael Coleman**
- VIII. 2012 Pension Reform Update - Dwight Stenbakken, League Deputy Director.** *Informational*
- VII. Next Meeting: Annual Conference, San Diego, September 5, 9:00 – 10:30 A.M.**
Staff will notify committee members after July 7th if the policy committee will be meeting in September.

Brown Act Reminder: The League of California Cities' Board of Directors has a policy of complying with the spirit of open meeting laws. Generally, off-agenda items may be taken up only if:

- 1) Two-thirds of the policy committee members find a need for immediate action exists and the need to take action came to the attention of the policy committee after the agenda was prepared (Note: If fewer than two-thirds of policy committee members are present, taking up an off-agenda item requires a unanimous vote); or*
- 2) A majority of the policy committee finds an emergency (for example: work stoppage or disaster) exists.*

A majority of a city council may not, consistent with the Brown Act, discuss specific substantive issues among themselves at League meetings. Any such discussion is subject to the Brown Act and must occur in a meeting that complies with its requirements.

NOTE: Policy committee members should be aware that lunch is usually served at these meetings. The state's Fair Political Practices Commission takes the position that the value of the lunch should be reported on city officials' statement of economic interests form. Because of the service you provide at these meetings, the League takes the position that the value of the lunch should be reported as income (in return for your service to the committee) as opposed to a gift (note that this is not income for state or federal income tax purposes—just Political Reform Act reporting purposes). The League has been persistent, but unsuccessful, in attempting to change the FPPC's mind about this interpretation. As such, we feel we need to let you know about the issue so you can determine your course of action.

If you would prefer not to have to report the value of the lunches as income, we will let you know the amount so you may reimburse the League. The lunches tend to run in the \$30 to \$45 range. To review a copy of the FPPC's most recent letter on this issue, please go to www.cacities.org/FPPCletter on the League's Website.

ATTACHMENT A

League of California Cities Revenue and Taxation Committee

Policy Issue: Sales Tax Sharing Agreements—Internet Retailers

Summary: Recent press accounts have disclosed that giant internet retailer Amazon.com is building two giant warehouses in California to distribute their products, one in the City of Patterson the other in the City of San Bernardino. Those cities either have already, or are considering, entering into agreements providing major rebates of the local portion of sales taxes to the company. Legislators are discussing introducing legislation to restrict or ban the practice of local sales tax rebates. Given that such legislation would affect local flexibility, and city officials may have anticipated collecting revenue from internet sales from sites like Amazon.com, the League should examine its policies on this issue.

Background: Over the last few years, the League has spent significant time developing policy and examining alternatives to increase the collection of use tax that is lost to internet sales. Many internet sales are attributed to the rise of Amazon.com, a large internet retailer. Amazon's previous business strategy was to avoid establishing physical nexus with states like California, to avoid the obligation to collect sales and use tax on their products. But now they are changing their strategy.

A subcommittee of the League's Revenue and Taxation Committee recently reviewed and made recommendations on pending federal legislation, including S. 1832 (Enzi), which would require internet retailers to collect and remit sales and use tax. During the League's discussion of the federal proposal, much time was spent refining a provision that would ensure that the revenues collected under the federal law would be collected at the "destination" tax rates charged by the local jurisdiction where the product was shipped. In other words, if a pair of tennis shoes is purchased online and sent to Marysville, Marysville should get the tax revenue.

The "destination rate" proposal for allocation of internet sales somewhat tracks the situs-allocation model because the revenues are being allocated to the location where the purchaser presumably ordered and takes delivery of the item.

Existing League Policy: The League has a long history of supporting situs-based distribution of existing sales tax revenue, but with several exceptions:

1. The policy allows that a future new regional or state tax could be distributed on a regional basis, but that has not yet occurred.
2. The policy recognizes that "restrictions should be implemented" when a business is formed that diverts sales tax revenues from other regions (See SB 27 issue below).

Revenue from new regional or state taxes or from increased sales tax rates should be distributed in a way that reduces competition for situs-based revenue. (Revenue from the existing sales tax rate and base, including future growth from increased sales or the opening of new retail centers, should continue to be returned to the point of sale.)

The existing situs-based sales tax under the Bradley Burns 1% baseline should be preserved and protected. Restrictions should be implemented and enforced to prohibit the expansion of

questionable businesses formed to circumvent the principle of situs-based sales and used to divert sales tax revenues from other regions in return for favorable treatment.

SB 27 (Hancock): In 2008, the League debated and supported legislation that responded to a strategy being employed by a sales tax consultant that resulted in the diversion of millions in sales tax revenue from Livermore and other cities to a storefront sales office in the City of Fillmore. This resulted in the passage of SB 27 (Hancock) in 2009. The law now prohibits a local agency from entering into any form of agreement that results, directly or indirectly, in the payment, transfer, diversion or rebate of any amount of Bradley-Burns local sales and use tax proceeds to any person for any purpose when both of the following apply:

1. The agreement results in a reduction in the amount of Bradley-Burns tax proceeds received by another local agency from a retailer within the territorial jurisdiction of that other local agency; and
2. The retailer continues to maintain a physical presence within the territorial jurisdiction of that other local agency.

Policy Issues:

1. Offering incentives to attract a business or major employer to a city is a standard practice. California cities compete with locations within California and other states. States do the same thing. California offers tax incentives: \$100 million in sales tax rebates is offered annually to recruit and retain “green” manufacturing through the Treasurer’s office, companies in enterprise zones realize approximately \$500 million in state tax breaks, and the recently enacted single-sales factor costs the General Fund \$1 billion annually.
2. By locating a giant warehouse in several California cities, Amazon will establish physical nexus in the state and “situs” in the specific locations. That means sales taxes will be collected from items shipped from the warehouses. To the state it makes no difference where the warehouses are, but to local agencies situs allocation means that the cities with the warehouses will garner an estimated \$8 million each in local revenue.
3. Is there a problem with several cities landing the massive Amazon warehouses and providing a tax rebate to the company from the local portion of the sales tax, or is there something about the scale of this issue, or that the company is a major internet retailer, that makes it different? If so, what?
4. Some legislators, and even city officials, will argue that the practice of giving local sales tax rebates encourages communities to cannibalize each other, and corporations exploit this in a “race to the bottom.” Should the practice of local sales tax givebacks be banned, or banned if over a certain threshold?
5. Giant warehouse distribution centers are a growing feature of the nation’s economy. Is there something about the practice of local sales tax rebates to these entities that should be addressed in legislation either by a cap or ban? Should a “destination-based” allocation be considered for warehouses over a certain size or dollar volume? If not, why not?

Amazon poised to get a cut of California sales taxes

Eager to host Amazon warehouses and receive a cut of the tax on sales to customers statewide, two California cities are offering Amazon most of the tax money they stand to gain.

By Marc Lifsher, Los Angeles Times

8:57 PM PDT, May 19, 2012

PATTERSON, Calif. —Amazon.com Inc. for years has fought government efforts to tax e-commerce. Now it's poised to pocket millions of dollars in sales taxes paid by California customers.

As part of a pact reached last year with state lawmakers, some online retailers agreed to begin collecting sales taxes this fall. About half of the projected \$316 million raised in the first full year is expected to come from merchandise sold by Amazon, which is also setting up two California fulfillment centers that will employ at least 1,000 workers each.

San Bernardino and Patterson, where the centers will be located, will gain not only jobs but also a tax bonanza: Sales to Amazon customers throughout California will be deemed to take place there, so all the sales tax earmarked for local government operations will go to those two cities. It's a windfall so lucrative — about \$8 million a year initially for each city — that local officials are preparing to give Amazon the lion's share of their take as a reward for setting up shop there.

Talks with Amazon about a so-called sales-tax rebate are still in the early stages. But in Patterson, a struggling Central California community of 21,000, Mayor Luis I. Molina said he's ready to do what it takes to help his city.

"This is huge. This is monumental, not only for the city but for the county and the region," he said. "We're up to 20% unemployment, and this is going to make a dent."

But critics worry that any deal would embolden other retailers to demand similar concessions at a time when California cities are scrambling to plug budget holes. Particularly grating, some said, is the idea that Amazon — whose business model long was based on selling merchandise without collecting taxes — could now profit from those levies.

"The tax is supposed to be supporting government," said Lenny Goldberg, executive director of the California Tax Reform Assn. "Instead, it's going back into Amazon's pocket."

Amazon did not respond to repeated requests for comment.

The potential pact is already attracting the attention of some California legislators seeking to ban so-called sales-tax rebates. Once used to attract sizable retailers such as car dealerships, these incentives are mushrooming as cash-strapped communities compete with one another to land big sales-tax generators.

That arms race is cheating taxpayers, who want their money spent on parks, police and street repairs,

said Sen. Mark DeSaulnier (D-Concord), who is considering introducing a bill this session to address the issue.

"It seems like the private sector finds a way to pit one city against the other," said DeSaulnier, a former city councilman and mayor. "You can't give away sales tax in this manner."

The proposed rebates are just the latest dust-up involving Amazon and sales taxes.

The company for years took advantage of a U.S. Supreme Court decision that exempted it from collecting sales taxes on most online purchases in states where it had no stores or warehouses. That enabled Amazon to undercut prices charged by its bricks-and-mortar competitors, such as Wal-Mart Stores Inc. and Target Corp.

Pressure from traditional merchants, combined with state budget woes, prompted California and other states to pass legislation requiring online sellers to begin collecting the levies from their customers.

Amazon last year launched a costly campaign to try to overturn California's 2011 law with a ballot measure. The company backed off after the state agreed to delay implementing the measure until Sept. 15 of this year.

In California, about one-tenth of the statewide standard sales-tax rate of 7.25% goes to the city or jurisdiction where the retailer operates, with the rest going to the state and county. Amazon currently has no physical warehouse operations in California. So initially, all of the state's cities will split those taxes, based on their residents' share of Amazon purchases.

That will change next year, however, when the million-square-foot fulfillment centers open in Patterson and San Bernardino. California law allows some merchants to designate a legal "point of sale," permitting them to direct 100% of the city share of sales taxes to a specific community where they have a physical presence.

This gives online retailers such as Amazon tremendous leverage to negotiate sales-tax rebates from cities that want one of their facilities.

"The incentive to compete and to steal tax dollars from other jurisdictions is really, really high," said Geoffrey Progheter, a research assistant at George Washington University's Institute of Public Policy who studies municipal government finance.

For Patterson, dubbed the Apricot Capital of the World and located just off Interstate 5 in Stanislaus County, the projected bonanza is nearly as big as its entire general fund.

City Manager Rod Butler said the city is considering rebating as much as 75% of its share of sales-tax revenues to Amazon. He reasons that even a reduced share of those taxes would enable the city to balance its budget and pay for city parks, streets and garbage collection.

Patterson "is not ashamed about taking advantage" of any legal tools available for economic development, he said, in part because rival communities are doing the same thing. In December, the nearby city of Tracy expanded its existing sales-tax-sharing plan to include e-commerce warehouse and shipping facilities in hopes of attracting Amazon.

San Bernardino, meanwhile, is working on an agreement with Amazon that would give the retailer as much as 80% of its share of sales taxes in the first few years, according to city spokesman Jim Morris. Two years ago the city inked a similar deal for Internet sales with department store chain Kohl's Corp. that gradually reduces the retailer's cut to 20%.

"We've discussed with Amazon the possibility of some sort of sales-tax agreement," Morris said.

Sales-tax rebates are so lucrative that economic development consultants are urging their corporate clients to demand them. California's "point of sale" policy helps merchants pit revenue-hungry cities against one another for the best deal, said Susan Russell, a North Barrington, Ill., tax and economic development consultant.

"This gives the state a unique opportunity to attract business, especially from Internet companies," she said, calling such tax-sharing agreements "a win-win for everybody."

But California communities shut out of the sales-tax windfall are starting to wake up to this inequity as Internet commerce explodes, said Dan Carrigg, legislative director of the League of California Cities.

"We know that there's a lot of sales volume that takes place on sites like Amazon. The purchasers that use that website are dispersed all over the state," he said. "I think there would be concern among the cities of California if that [sales-tax] revenue they thought they would capture was not going to become available."

Cities are already fighting in court for their share in such cases. San Diego, Palo Alto, Livermore and Industry will soon be splitting \$12.4 million in sales taxes they said were siphoned illegally by the city of Fillmore. In proceedings before the state Board of Equalization, they accused medical-equipment giant Owens & Minor of setting up a "sham office" in Fillmore that routed local sales taxes to that city even though the company's California distribution centers were in their cities. Fillmore rebated much of those funds to Owens & Minor and a broker who set up the 2007 deal. An appeals court last year ruled in favor of the plaintiffs.

"Sales-tax dollars generated locally are supposed to be used for local services," Livermore Mayor Marshall Kamena said in a statement.

In the meantime, the giveaways continue. The Bay Area city of Martinez this month approved a sales-tax-sharing agreement with S&S Supplies and Solutions, a seller of industrial supplies. Under that deal, the city will give up 80% of sales taxes generated by future growth in company sales. That works out to about \$800,000 annually by 2015 if S&S sales hit company targets.

City Manager Philip Vince said he recommended that pact, but only because he feared that the company would relocate. "It's kind of the worst nightmare," Vince said. "We'd like to have the growth and the full sales tax."

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**SB 1151 and SB 1156 (Steinberg) Post-RDA Asset Retention and Authority
Brief Summary of May 29, Amends**

Senate Pro Tem. Darrell Steinberg (D-Sacramento) introduced two measures in the aftermath of redevelopment dissolution: SB 1151 and SB 1156. The bills are structured to operate somewhat in tandem. SB 1151 focuses on the management of assets (cash and real property) from a former redevelopment agency (RDA). SB 1156 reauthorizes the use of redevelopment authority under limited circumstances. Both bills were recently amended on May 29, and passed the Senate, and will likely be scheduled for hearing soon in the Assembly. These measures need to be evaluated both for their usefulness in asset retention, and as a redevelopment/economic development tool going forward.

The League continues seek to work with the author's office in an effort to make these measures more useful to cities. The League also continues to develop options in its task force, and work with other legislators and interest groups on other approaches to asset retention, tools for infrastructure and economic development and affordable housing.

Below is a description of the contents of these bills, and links to the text, followed by several comments and considerations for cities.

SB 1151 (Steinberg)

http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_1151-1200/sb_1151_bill_20120529_amended_sen_v97.html

- 1) Provides that the required cash transfers to the auditor-controller under AB x1 26 of unencumbered balances of a former redevelopment agency, including but not limited to, the unencumbered balance of the Low and Moderate Income Housing Fund, shall not apply where a Community Development and Housing Joint Powers Agency has been formed. In place of the auditor-controller, these transfers must be made to the Sustainable Economic Development Housing Trust Fund. *(This cross reference to SB 1156 is no longer accurate, because the May 29 amendments to SB 1156 now refer to a "Sustainable Communities Investment Authority (Authority))*
- 2) Provides that **all** assets and properties that would otherwise be disposed of pursuant to AB x1 26 shall be transferred to a "Sustainable Economic Development and Housing Trust Fund (Trust)," regardless of whether an Authority has been formed under SB 1156.
- 3) Requires an Authority, or in its absence an Oversight Board, to prepare a long-term asset management plan (Plan) which shall govern the disposition and ongoing use of assets in the Trust. Prohibits any assets from being disposed until the Plan is approved by the Department of Finance (DOF).
- 4) Requires the Plan to:
 - a) include detailed information about the assets in the trust. Authorizes the trust to accept funds from any other source.
 - b) include a strategy for maximizing the long-term social and monetary value of the real property and assets for the purpose of creating high wage, high skill jobs and affordable housing.
 - c) address the use or disposition of all assets in the trust. States that it is not necessary to maximize the monetary value of the asset if alternative deployment of the asset furthers social and community objectives determined by the JPA consistent with the article. Prohibits property disposed from being subject to real estate speculation.

- 5) Requires DOF to approve the plan by Dec. 1, 2012, or return it to the JPA for revisions prior to final approval no later than December 31, 2012. DOF can establish a “*minimum asset distribution requirement*” to ensure schools and local agencies receive a minimal amount of funding from the dissolution of assets. Requires the plan to be updated and reviewed by DOF annually.
- 6) Authorizes the proceeds of asset sales to be retained in the Trust and used for sustainable housing and economic development activities by an Authority and not distributed as property tax to taxing entities.
- 7) Authorizes the trust fund to be used for:
 - a) Purchase, acquisition, financing or maintenance of public and private infrastructure needed for infill development consistent with SB 375.
 - b) Affordable housing.
 - c) Transitional housing for former inmates assigned to counties through 2011 realignment.
 - d) Loans to public or private entities for development activities.
 - e) Environmental mitigation, including brownfield remediation.
 - f) Payment of liabilities of former redevelopment agency.
 - d) Land acquisition.
 - e) Clean energy and energy efficiency investments.
 - f) Educational, labor management and job training programs in high need high growth, etc. Trust can accept funds from any other source.
- 8) Requires all entities receiving financial support from or authorized by this article to incorporate into any and all agreements a "jobs plan" that would create construction careers that pay prevailing wages, living wage permanent jobs and a program for community outreach, local hire and job training. Requires the “jobs plan” to describe the project developer’s commitment to hire, disadvantaged CA residents, veterans from Iraq and Afghanistan, people with a history in the criminal justice system and single-parent families.

Comments:

- 1) The recent changes in this measure need to be evaluated against the requirements of existing law in AB x1 26. From a successor agency and oversight board’s perspective, existing law may be preferable to the process outlined in this bill.
- 2) In the current budget environment, the notion of retaining all cash assets of a former RDA if an Authority is formed sounds appealing, but is likely unrealistic. DOF could, under the vague standard of a “minimum asset distribution requirement,” strip out any revenue it desires as a condition of approving a Plan.
- 3) No limits are imposed on what DOF can remove from the Trust. For instance, what is a “minimum” amount? Is there any maximum? DOF does not appear limited to the property tax shares under AB 8. However, attempting to shift more property tax from local agencies to schools would violate Proposition 1A, and attempting to allocate between other local agencies more than their traditional share would require a 2/3rds vote. The Trust is administered by an Authority if one is formed. If one is not formed, the legislation is unclear on how the Trust is administered.
- 4) The notion of doing a comprehensive asset management Plan by an Authority or Oversight Board makes little sense when local input will be swept aside by decisions of the DOF, which is not required to take any local considerations or planning issues into account. For instance, if a community desires to retain a key parcel for a transit-oriented development, DOF could insist that the parcel be sold.
- 5) The “jobs plan” required by all entities authorized by, or receiving financial support under the article, imposes significantly restrictive conditions that will limit the usefulness of the tool. Rather than acknowledging that public works jobs funded under the Authority or by the Trust shall pay prevailing

wage, the plan goes farther and requires that the projects must create “careers” that pay prevailing wages and living wages, and include a program for community outreach, local hire and job training. An entity receiving assistance must incorporate these provisions into any and all agreements, including a commitment to offer jobs to disadvantaged California residents, people with a history in the criminal justice system, single-parent families and veterans. These conditions will increase costs of projects and impose significant ongoing administrative burdens that would not be required from other sources of financing.

- 6) Possible Alternative Process: The upcoming state budget is expected to target any unencumbered former redevelopment agency funds for state budget relief. That will leave the question of how to handle the physical assets going forward. Rather than the process outlined above, the following alternative process could be considered:
 - a) successor agencies and oversight boards could be empowered to adopt a long-range asset management plan, with a time horizon of between 7-10 years. To ensure sufficient time for the development of a thoughtful plan, 12 to 18 months could be allowed for its completion. The plan should identify:
 - b) assets that serve a public purpose that should be transferred to the appropriate agency.
 - c) properties that should be sold perhaps over a three to five year period to ensure maximum value to the taxpayer and affected entities.
 - d) Properties and assets that should be retained and developed for the benefit of the affected community and taxing entities, within a fixed time frame of perhaps up to five years.,
 - e) DOF should be able to comment on these plans, and for the comments to be considered, but provide oversight boards with final authority to approve a plan.
 - f) Require the plan to have a fixed end date by which all properties and assets of the former redevelopment agency are disposed of.

SB 1156 (Steinberg)

http://www.leginfo.ca.gov/pub/11-12/bill/sen/sb_1151-1200/sb_1156_bill_20120529_amended_sen_v95.html

- 1) Authorizes the creation in an incorporated area of a Sustainable Communities Investment Authority (Authority), after July 2012, to carry out limited provisions of Community Redevelopment Law. New amendments appear to limit its purposes to the development of low and moderate income housing. If the Authority is formed by the county alone, a county may exercise redevelopment authority without a JPA.
- 2) Excludes property tax shares for school districts and special districts from the application of tax increment financing.
- 3) If the authority is located within a city, authorizes the following types of governance structures:
 - a) The legislative body of the city forms the governing board and establishes the parameters of the proposed economic development within a proposed “sustainable communities investment area.” The economic development parameters, however, must be approved by the county.
 - b) The legislative body of the city appoints the governing board and designates a sustainable communities investment area consisting of a single project that designates 100 percent of tax increment to the project. The designation of the sustainable communities investment area, however, must be approved by the county.
 - c) A governing body for a sustainable communities investment area of two city, two county and one special district member.
 - d) A JPA formed between a city and a county.

- 4) Authorizes an Authority to adopt a plan for a sustainable communities investment area, without making a determination of “blight,” and actions are not required to remove blight. The plan shall terminate within 30 years from the date in which bonds are first issued.
- 5) Authorizes an Authority to enter into agreements with schools, community colleges and private businesses to “facilitate career technical education pathways,” as defined.
- 6) Project areas are limited to the following:
 - a) Areas within an adopted sustainable communities strategy that are either transit priority areas as defined by SB 375, or small walkable communities as defined by the bill.
 - b) Sites for clean energy manufacturing, consistent with a sustainable communities strategy.
- 7) Authorizes a plan to include the receipt of tax increment, provided the local government with land use jurisdiction has adopted:
 - a) A strategy for mitigating unfunded service impacts to public services including police, fire and rescue
 - b) A sustainable parking standards ordinance that restricts parking in transit priority project areas.
 - c) For transit priority areas and walkable communities the use designations, density, building and other provisions of the sustainable communities strategy shall apply with a minimum residential density of 20 units per acre and for non-residential uses a floor area ratio of not less than 0.75. The Metropolitan Planning Organization (MPO) must concur that the plan is consistent with the SCS.
 - d) For small walkable communities outside a MPO, a minimum residential density of 20 units per acre and for non-residential uses a floor area ratio of not less than 0.75. Defines “small walkable communities” to mean: areas within a city that is located outside the boundary of an MPO, with a project area not exceeding one-quarter mile, includes a residential area adjacent to a commercial area, has an average residential net density of not less than 8 units per acre and a floor area ratio of not less than 0.50 for non-residential uses.
 - e) A “jobs plan” that would create construction careers that pay prevailing wages, living wage permanent jobs and a program for community outreach, local hire and job training. Requires the “jobs plan” to describe the project developer’s commitment to hire, disadvantaged CA residents, veterans from Iraq and Afghanistan, people with a history in the criminal justice system and single-parent families.
- 8) Authorizes state and local pension funds to invest in capital infrastructure projects and private commercial and residential development undertaken by a JPA. Authorizes an agency to use Marks-Roos bond pooling and implement transactions and use tax.
- 9) Establishes an extensive construction prequalification process to apply to all construction contracts in excess of \$1 million, under taken by the Authority or private developers.

Comments:

- 1) Requiring county approval as a condition of accessing the provisions of this measure will limit its application. Many counties may not see value in entering into a JPA, or could reject a city’s proposals for undefined reasons. Counties could also insist on other conditions that would make such efforts unpalatable. Cities may view this structure as too limiting to their local authority.
- 2) While there are various governance structures proposed involving cities, county approval is required in all instances. It is unclear what benefit these structures provide. Involving a special district in one of the models makes little sense, when another section of the bill excludes their property tax allocations from tax increment financing.
- 3) The scope of activities that may be undertaken seems to be limited to affordable housing. While there is reference to “economic development” and “clean energy” elsewhere in the bill there are major drafting questions about what activity an authority could undertake. For instance, can it fund basic infrastructure repair in an urban area? Can it clean up a brownfield? If the bill is limited to

affordable housing, then tax increment financing may make little sense, since many affordable housing projects pay no property taxes under the welfare exemption.

- 4) SB 1156, however, imposes numerous restrictive conditions on the entity with land use authority (the city) which must be closely evaluated. It appears that the city would have to bear the full costs of mitigating unfunded impacts to public safety services, to develop a parking ordinance, a jobs plan, a construction bidding prequalification regime, and it is unclear if these costs could be offset with tax increment.
- 5) The amount of tax increment in the legislation is limited to city and county shares, and shares for school districts and special districts are excluded. A much more useful mechanism would to establish an optional system that matches a governance structure with agency participation: If the authority only uses the city's share of property taxes, the city's ability to establish the authority should not require the approval of another agency. If the county or special district's shares are to be included, then it should be with their agreement and a governance structure to match. Some authority should be provided for the state to participate via the school share, if the state agrees.
- 6) The types of projects eligible for funding must be broader for the tool to be useful. In addition the many other conditions applied to the jurisdiction with land use authority will likely limit interest.
- 7) While numerous questions are raised by the May 29 amendments, such measures are likely to change in the coming weeks as the author's office receives input from the League and other stakeholders.

**Cap and Trade Policy Discussion- June 2012
Briefing/Agenda Item for EQ, HC&ED, TC&PW, and Rev and Tax**

Cap and Trade Auction Revenues

Summary:

Beginning this fall, the State Air Resources Board will be running a Cap and Trade program that is projected to provide a multi-billion annual revenue stream. A significant portion of these funds will likely be available to local government. Staff is seeking input from the Environmental Quality; Transportation, Communication & Public Works; Housing, Community & Economic Development; and, Revenue and Taxation Committees on the Cap and Trade Auction revenues.

Background:

A key element of California's greenhouse gas reduction program under AB 32 is the State's "Cap and Trade" program. The program works by establishing a hard cap on about 85 percent of the total statewide greenhouse gas emissions. This includes industries like mining, oil production and energy production, manufacturing plants, transportation fuels and others. The State Air Resources Board will issue emission "allowances" equal to the total amount of allowable emissions over a given compliance period. Then, entities that are regulated under the program will be able to "trade" or buy and sell a portion of these allowances. Each allowance is equal to one ton of greenhouse gases. As the overall cap declines, fewer allowances will be available.

This August, the Air Resources Board will hold a practice auction, which will be followed by the first real auction on November 14th. In 2013, the Air Board will begin its regular quarterly auctions (*expected to be held in January, March, August and November*)

Over time, the auctions are estimated to generate into the billions annually for the state. It is estimated the first auction (November 2012) will raise between \$660 million and \$3 billion in the 2012-13 fiscal year. In future years, it's estimated that the auctions may raise between \$3 and \$14 billion annually. There are still questions surrounding exactly how much the auctions will raise until they actually happen. It's also important to note that the bulk of the money will be raised after 2015 when the transportation fuel and residential and natural gas sectors are included in the auctions.

The current proposed Governor's budget assumes the state will receive \$1 billion from the auctions and assumes that \$500 million of that money will go to offsetting existing greenhouse gas mitigation activities and the other \$500 million for new or expanded programs intended to reduce greenhouse gas emissions. Potential areas that revenue could be directed to include low carbon transportation and infrastructure, clean and efficient energy, and natural resources protection.

There are also four bills (*AB 2404 (Fuentes), AB 1532 (Perez), AB 1186 (Skinner) and SB 1572 (Pavley)*) that all outline ways to spend the auction revenues. AB 2404 was held on the Assembly Appropriations Suspense File (dead) while the remaining three are in the second house

but are considered “works-in-progress” and will likely be changing over the next few months.

While AB 2404 (Fuentes) was held on the Assembly Appropriations Suspense File, League staff remains concerned that the language may end up in one of the other remaining bills. Of particular concern is the requirement that all Cap and Trade Auction revenues would be given out as competitive grants from the State Strategic Growth Council (regardless of issue area) and only counties or groups of counties would be eligible for the funds. Because of this, League staff is recommending an oppose position on AB 2404 to stop the provisions of the bill from reemerging in another bill.

Staff Recommendation:

Staff recommends an oppose position on AB 2404 (Fuentes) and a discussion on the broader areas of potential revenue from Cap and Trade auctions.

Fiscal Impact: Potentially billions in new revenue for programs and policies at the local level.

Existing League Policy:

From Environmental Quality:

- Green Technology Investment Assistance. Support tax credits, grants, loans and other incentives to assist the public, businesses, and local agencies that invest in energy efficient equipment and technology, and fuel efficient low emission vehicles.

From Revenue and Taxation:

- Additional revenue is required in the state/local revenue structure. There is not enough money generated by the current system or allocated to the local level by the current system to meet the requirements of a growing population and deteriorating services and facilities.

From Transportation, Communication and Public Works:

- The League supports additional funding for local transportation and other critical unmet infrastructure needs.

Comments:

1. *AB 2404 (Fuentes).* AB 2404 was held on the Assembly Suspense File and is effectively dead. However, as with many bills, it is likely that pieces of AB 2404 will end up in other proposals. The League did not take a formal position on the bill, but did convey concerns to the author’s office regarding the money going out through the State Strategic Growth Council and the bill’s provisions that would not allow individual cities to apply for any of the funds. Staff recommends an oppose position on AB 2404, even though the bill is dead, to allow staff to fend off the two concerning provisions noted above.
2. *Sinclair Nexus Test.* Revenues from Cap and Trade auctions are considered mitigation fee revenues and therefore will need to be strictly held to what’s known as the Sinclair nexus test, based on the 1997 California Supreme Court Case, *Sinclair Paint vs. State Board of Equalization*, which requires that a clear nexus exist between an activity for which a

mitigation fee is used and the adverse effects related to the activity on which that fee is levied. This will be an important point going forward as both the administration and legislature are making sure that any revenue coming from the auction and going out to the community will be strictly held to this test.

3. *Proposal for Transportation Fuels Revenues.* Motor vehicle fuels comprise approximately 40 percent of the state's GHG emissions and will fall under the cap beginning in 2015. There is an argument that a corresponding amount of the Cap and Trade Auction revenues should be dedicated to transportation programs that would reduce GHG emissions. Some draft principles for use of the transportation-related revenues are:
 - a. *Dedicate the allocation revenues related to fuels to transportation investments.*
 - b. *Invest a major portion of those dedicated revenues directly into transportation infrastructure, operations, and maintenance.*
 - c. *Structure the investments to favor integrated transportation infrastructure investments.*
 - d. *Use these transportation investments to provide the incentives and assistance that local governments need to make SB 375 work.*
 - e. *Allow flexibility at the regional and local level to develop the most cost effective ways to meet both transportation and greenhouse reduction goals.*
 - f. *Invest in improved modeling and verification systems and use those to provide assurance that local strategies meet both GHG and cost effectiveness goals.*
4. *Lots of Programs to Fund.* Under the various proposals for Cap and Trade Auction revenues a multitude of proposals for programs to fund have emerged. They range from funding solar panels for schools, to transportation planning, to water infrastructure. A few key areas have emerged that may be helpful as guidelines for types of programs that may ultimately be funded:
 - a. *Revenues directed towards low-carbon transportation infrastructure.*
 - b. *Clean and efficient energy.*
 - c. *Natural resources protection.*
5. *Regional Governments vs. Individual Cities or Counties and Other Questions on Revenue Delivery.* Many of the discussions League staff has had on new revenues have suggested the funds should go out through regional government bodies to encourage regional projects and planning. One area of discussion for the committee is whether or not there is a preference for how revenues from Cap and Trade Auctions are delivered. Should they be on a regional basis? Available to individual cities, or both options? What if the funds are connected to the completion of a Sustainable Communities Strategy or some other plan related to GHG emission reductions? Should those plans be certified or approved by a state agency?
6. *Program Accountability.* With such a significant amount of money at stake from the auctions, a number of groups in Sacramento are calling for some kind of reporting or other form of accountability to show that the programs and policies the auction revenues are funding are reducing GHG emissions. Is annual or bi-annual reporting on programs and policies receiving funding from auction revenues appropriate? If not, why? What should happen if the programs funded by auction revenues don't achieve the results expected?

7. *Will the revenues remain stable over time?* At this point it's still unclear. Until the November 2012 auction (which is the first real auction), no one knows exactly what revenues will be available. The Administration has suggested the revenues for 2012-2013 may be in the range of \$600 million to \$3 billion and ultimately could go as high as \$14 billion per year. However, auction revenues are intended to lessen each year. This is because as we get closer to 2020, our overall amount of GHG's should be lower so there should be fewer allocations in the auction, thus less revenue coming in. Additionally, with up to 4 auctions per year proposed, auction revenues may vary from auction to auction.
8. *Is there an end date for the revenues?* AB 32 requires the State meet 1990 levels of GHG emission by 2020. It remains unclear exactly what will happen as we get closer to 2020, but the State has done some planning. In 2005, then Governor Schwarzenegger issued an Executive Order that established a state target for GHG emission reductions to 80 percent below 1990 levels by 2050. Additionally, ARB in its Scoping Plan looked well past 2020 to 2030 and 2050 and provided thoughts as to what might be possible in the future. Regional targets required by SB 375 and set by the ARB included target dates for both 2020 and 2035. Finally, it is also highly likely that the next update of the ARB Scoping Plan or a future legislative measure will extend the provisions of both AB 32 (with a new goal and new date) as well as the Cap and Trade program.

Questions for League Policy Committees:

1. Do you concur with staff's proposal to oppose AB 2404 (see Comment #1)?
2. Do you support the concept Comment #3 of dedicating revenues derived from transportation fuels to transportation purposes?
3. Regarding the delivery process of revenues:
 - a. Should they be on a regional basis or available to individual cities, or both? Does it depend on the program or industry the revenues are derived from?
 - b. What if the funds are connected to the completion of a Sustainable Communities Strategy or some other plan related to GHG emission reductions? Should those plans be certified or approved by a state agency?
4. Is annual or bi-annual reporting on programs and policies receiving funding from auction revenues appropriate? If not, why? What should happen if the programs funded by auction revenues don't achieve the results expected?

Cap and Trade Auction Revenue Proposals

Bill/Proposal	AB 2404 (Fuentes)	AB 1532 (Perez)	SB 1572 (Pavley)	AB 1186 (Skinner)	Governor's Budget	Legislative Budget Response
Summary	Creates the Local Emission Reduction Program to provide local assistance grants to develop and implement multi-benefit greenhouse gas emission reduction projects in California's communities funded by Cap and Trade auction revenues	Establishes policy and procedures for fee revenues derived from Cap and Trade auctions.	Sets up the Greenhouse Gas Reduction Fund within the Air Resources Board to allocate Cap and Trade Auction revenues. Funds will only be available to go out upon appropriation of the Legislature through the annual Budget process.	Directs California Public Utilities Commission (CPUC) to require Investor Owned Utilities (IOU's) that receive auction revenues to designate a portion of the funds to go toward cost-effective school energy efficiency improvements. This would be done through the CPUC's oversight of the IOU's expenditure plan.	The Governor's January Budget proposal provides \$1 billion total in 2012-13. \$500 million for existing GHG mitigation activities, \$500 million for investments in 1) clean and efficient energy, 2) low carbon transportation, 3) natural resources protection, and 4) sustainable infrastructure.	Creates the Greenhouse Gas Reduction Fund in the State Treasury for auction revenues.
Who gives out money?	Strategic Growth Council	Various State Agencies through existing programs	ARB, upon appropriation of the Legislature through the annual Budget process.	CPUC	Unknown.	Unknown.
Grants/Loans?	Grants	Competitive grants, revolving loans, loan guarantees, loans or other appropriate funding measures.	Unknown.	Neither, CPUC direction to IOU's in revenue plans.	Unknown.	Unknown.
Money on Regional or city basis?	Only counties or groups of counties are eligible for funds.	Both options are likely.	Unknown.	n/a	Unknown.	Unknown.
Competitive grants?	All grants awarded on competitive basis	Yes, see above.	Unknown.	n/a	Unknown.	Unknown.
Additional Notes	In order to receive funds, counties must complete a GHG emission reduction plan certified by the State ARB, and that enters into a MOU with cities in its jurisdiction and others that choose to participate.	Funds will be available to a wide array of projects, through existing programs (EECBG, AB 118 are examples) to a number of different groups. Planning funds for SB 375 implementation are likely to be a part of this proposal.	Bill is still a work-in-progress. Senate members have a "working group" working on ideas for the bill.	Funds are available for schools only.	Under Budget proposal, after the first auction, the Governor would submit an expenditure plan to the Legislature	Identical language was passed in both Senate and Assembly Sub-Committees. Requires funds to meet AB 32 and Sinclair Fee nexus. Absent legislation passing on revenues, directs the Administration to submit a bill for expenditure of the revenues no later than January 10, 2013.