



DEPARTMENT OF  
**FINANCE**  
OFFICE OF THE DIRECTOR

GRAY DAVIS, GOVERNOR

STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO, CA ■ 95814-4998 ■ WWW.DDF.CA.GOV

June 20, 2003

Mr. Steven Gourley, Director  
Department of Motor Vehicles  
2415 1st Avenue/MS: F-101  
Sacramento, CA 95818

Mr. Matthew O. Franklin, Director  
Department of Housing and Community Development  
1800 Third Street  
P.O. Box 952050  
Sacramento, CA 94252-2050

Dear Directors Gourley and Franklin:

Section 10754 of the Revenue and Taxation Code requires the Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD), as appropriate, to reduce Vehicle License Fee (VLF) offsets and restore the VLF during any period in which insufficient General Fund moneys are available to fully fund the offsets.

As of June 20, 2003, there will be insufficient moneys available to be transferred from the General Fund to fund the VLF offsets. On this date, the State will pay \$9.5 billion to retire a RAN obligation coming due. Thereafter, the State will be operating on cash derived from a \$10.965 billion RAW received on June 18, 2003, which will not be repaid until the following June.

Accordingly, insufficient General Fund moneys will be available to fund any portion of the offsets under Section 10754 starting on June 20, 2003.

Attached is a letter from counsel describing the operation of Section 10754 and your obligations under this provision.

Sincerely,



STEVE PEACE  
Director

cc: Honorable Steve Westly, State Controller  
Mr. Ken Miyao, Deputy Director, Department of Motor Vehicles  
Ms. Judy Nevis, Chief Deputy Director, Department of Housing and Community Development

**FINANCE**

**Date:** June 19, 2003  
**To:** Director Steve Peace  
**From:** Yoshie Fujiwara, <sup>YF</sup> Pat Landingham <sup>R</sup>  
**Subject:** Vehicle License Fee Offset Suspension

**Recommendation**

The Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD) should be notified that as of June 20, 2003, it can be reasonably estimated that there will be insufficient moneys available to be transferred from the General Fund to fund the Vehicle License Fee (VLF) offsets. This notification must be made based on an evaluation of the following information, including:

1. The issuance of \$11 billion of Revenue Anticipation Warrants (RAWs) on June 18.
2. The failure of the Legislature to fully adopt or fully replace the Governor's solution proposals.
3. The deterioration in revenues since 2003-04 Governor's Budget.
4. Additional expenditures due to caseload increases since 2003-04 Governor's Budget.

**1. Revenue Anticipation Warrants**

On April 30, we received a letter dated April 29 from the State Controller requesting the Governor's approval to issue \$11 billion of RAWs in mid June (Attachment A). The State will run out of cash, including exhausting all internal borrowable resources, by mid to late June. Even with the issuance of \$11 billion of RAWs, without a timely budget, the State will once again run out of cash by late summer. The actual issuance took place on June 18<sup>th</sup> (Attachment B).

**2. Governor's Solution Proposals Not Fully Approved or Replaced**

Of the \$5.5 billion 2002-03 mid-year solutions proposed by the Governor in January, only \$3.3 billion have been passed by the Legislature (Attachment C). Of the \$34.8 billion of 2003-04 solutions proposed at May Revision, the Legislature has passed \$3.6 billion to-date (Attachment D). Since the release of the Governor's Budget, \$690 million of solutions proposed by the Administration have been eroded (Attachment E). With each day of delay, more savings will be eroded. While we were optimistic that the Legislature would adopt alternative measures of equal magnitude to the Administration's proposals that were rejected, the Legislature has failed to take such action thus far.

### 3. Revenue Deterioration Since Governor's Budget

Since January 10, 2003, revenues for 2002-03 and 2003-04 are projected to decrease by \$612 million (Attachment F).

### 4. Increased Expenditures Since Governor's Budget

The May Revision reflected \$10.3 billion of additional expenditures (primarily due to scaling back of realignment proposals and caseload increase in the health and human services areas) over the 2002-03 and 2003-04 fiscal years combined (Attachment G).

### Background of the VLF Program

The VLF imposes a yearly license fee on any vehicle subject to registration in California in the amount of 2 percent of the market value of that vehicle. (Section 10751, et seq.) Beginning in 1998, the Legislature adopted Section 10754<sup>1</sup>, which provides that the total amount of the 2 percent VLF otherwise required shall be "offset" in accordance with its provisions. The current amended version of Section 10754 provides for an offset in an amount equal to 67.5 percent of the amount computed. Thus, at the time of registration, the vehicle owner pays 32.5 percent of the VLF, which is reported monthly, and the General Fund provides the remaining 67.5 percent. (Sections 10754, 11001, 11001.5)

Section 10754, subsection (a) (3)(C) provides the following:

"(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets, within 90 days of a reduction in funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets."

Thus, during any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets, both the DMV and the HCD are required to reduce proportionately the amount of each "offset", which has the effect of requiring each vehicle owner to again pay more, if not all, of the still existing 2 percent VLF.

### 2002-03 Budget

Based on the joint opinion dated March 7, 2003 (Attachment I), by the Chief Counsels of the Controller's Office and Finance, "[a] finding that insufficient General Fund moneys are 'available' may be made when there are insufficient funds to pay all State obligations, including the VLF, as budgeted."

The 2002 Budget Act adopted on September 5, 2002, projected revenues of \$79.2 billion and expenditures of \$76.7 billion and a positive fiscal year end reserve of \$1.0 billion. (Included in the expenditure totals was \$3.9 billion for VLF offset expenditures.) (Attachment J)

<sup>1</sup> Cal. Stats. 1998, ch. 322, sec. 2.

The 2003-04 Governor's Budget issued on January 10, 2003, projected the 2002-03 reserve would decline by \$6.9 billion, from \$1.0 billion to -\$5.9 billion, with revenues of \$73.1 billion and expenditures of \$75.5 billion (Attachment K).

The 2003-04 May Revision issued on May 14, 2003, projected the 2002-03 reserve would decline by another \$4.8 billion, from -\$5.9 billion to -\$10.7 billion, with revenues of \$70.8 billion and expenditures of \$78.1 billion (Attachment L). This decline was primarily attributable to the following:

- The difference between the amount of the Governor's Mid-Year proposals and the Legislature's actions on those proposals (\$2.2 billion). (Attachment C)
- A decline in expected revenues of \$2.4 billion (Attachment F).
- Caseload increases of about \$545 million (Attachment H).

The \$11.7 billion decline (from a positive \$1 billion to a negative \$10.7 billion) in the reserve since the 2002 Budget Act far exceeds the amounts budgeted (i.e., \$3.9 billion) to fund the VLF offset.

### 2002-03 Cash

The joint opinion dated March 7, 2003, by the Chief Counsels of the Controller's Office and Finance states that "[w]hile the analysis of the availability of money in the General Fund is primarily dependent upon budgetary considerations, actual cash as well as the competing claims on cash should also be considered." According to Finance's Chief Counsel, the timing of when the VLF trigger must be pulled (i.e., the State's obligation to fund the offsets ceases) is a cash determination and occurs, according to the VLF statute, when "insufficient moneys are available to be transferred from the General Fund" The joint opinion states that "[I]n making this determination, proceeds of all borrowings made to the General Fund which will not be repaid in the fiscal year of borrowing (such as a RAW borrowing) should not be considered to determine the sufficiency of moneys available."

The 2002 Budget Act adopted on September 5, 2002, estimated a \$6.8 billion cash cushion in unused borrowable resources at the fiscal year end based on cash flow projections using a fund cash basis (i.e., State Controller's basis) (Attachment M).

At the 2003-04 Governor's Budget issued on January 10, 2003, this cushion was revised and estimated to drop by \$5.2 billion, from \$6.8 billion to only \$1.6 billion (Attachment N).

At the 2003-04 May Revision, the State's cash position was expected to deteriorate even further. Because cash and borrowable resources were expected to be fully exhausted by mid to late June 2003, the State Controller issued \$11 billion of RAWs to maintain critical programs. Without this additional external borrowing, the cash cushion on June 30, 2003, would have dropped by another \$4.1 billion, from \$1.6 billion to -\$2.5 billion. (Attachment O reflects an adjusted cash cushion of \$8.529 billion. This amount includes \$11 billion of RAWs proceeds. Therefore, absent the RAWs proceeds, the cash balance would be a negative \$2.5 billion.) The revenue decline and the \$2.2 billion of lost mid-year corrective actions resulted in the need for additional external borrowing just to cover the cash needs in June 2003. The issuance of \$11 billion in June is to cover the cash needs through part of the summer and not to provide for moneys to be available for transfer from the General Fund to the VLF. All internal borrowable resources will also be fully exhausted. This is further evidenced by the Controller cash results: through the end of May, Controller cash was \$3.7 billion behind projections made at the time of the Governor's Budget (Attachments P and Q).

On June 20, \$9.5 billion of RANs will become due. Based on the May Revision cash flow, once this RANs payment is made, the State will essentially rely on the RAWs proceeds to pay its bills. (We note that another \$3 billion of RANs will become due on June 27.) Accordingly as of June 20, 2003, we can reasonably estimate that there will be insufficient moneys available to be transferred from the General Fund to fund the VLF offsets. We note that the May Revision cash flow projection was made based on certain assumptions and should not be construed as statements of facts. The assumptions were based on circumstances and best available information when the formal cash flow update was made at May Revision. The final outcome will be determined by a variety of factors that may or may not be the same as this projection.

### **2003-04 Budget**

Finally, the State's budget situation projection for 2003-04 indicates that its ability to fully fund the VLF offsets will be impaired for a significant period of time thereafter. When the 2003-04 May Revision was being prepared and before the application of budget solutions, it was clear that the projected General Fund revenues for 2003-04 would be \$11.9 billion below the 2002-03 revenue level in the 2002 Budget Act. In order to end the budget year with a modest General Fund reserve, \$38.2 billion of corrective budget actions were proposed, including the elimination of the funding to provide the VLF offsets. Even with such drastic measures, the projected General Fund reserve at the end of 2003-04 was projected at only \$509 million an amount insufficient to provide the full VLF backfill.

Of the \$38.2 billion needed corrective actions, the Legislature has approved \$6.9 billion (\$3.3 billion for 2002-03 and \$3.6 billion for 2003-04). It is clear that the intent of the original enabling statute for the VLF offset is to avoid harming other critical programs to fund the VLF offsets, and that this cannot be done under the current revenue and expenditure expectations. In any event, it is evident that, barring some dramatic unforeseen set of circumstances, it will be impossible to conclude that there will be sufficient money available to fund the VLF offset in the upcoming budget year.

### **Notification To DMV and HCD**

The joint opinion states that "[u]pon ascertaining that both the budget and the cash preconditions called for in the statute to continue the offsets cannot be met, the Department of Finance must give notice to the DMV and the Department of Housing and Community Development (HCD) that the statutory conditions necessary for the provision of the offset cannot be met."

In summary, the DMV and HCD must be notified to begin the necessary actions to send out the proper notices.

### **Attachments:**

- Attachment A—Letter from the SCO dated April 29, 2003
- Attachment B—Front Page of 2003 RAWs final Official Statement
- Attachment C—Finance prepared spreadsheet reflecting the Legislature's adoption of \$3.3 billion of mid-year reductions
- Attachment D—Senate Democrat Budget Plan (Finance reconciliation)
- Attachment E—Erosions as of 2003-04 May Revision (Finance prepared spreadsheet)

- Attachment F—General Fund Revenue Forecast as of the May Revision (page 21 of May Revision Report)
- Attachment G—Comparison of General Fund Expenditures at 2003-04 May Revision vs. 2003-04 Governor's Budget (Finance prepared spreadsheet)
- Attachment H—Increase in enrollment/caseload cost since Jan 10
- Attachment I—Joint Finance and Controller's chief counsel opinion dated March 7, 2003
- Attachment J—Budget Summary as of 2002 Budget Act (page 71 of 2002 Budget Act State Budget Highlights)
- Attachment K—Budget Summary as of 2003-04 Governor's Budget (page 119 of 2003-04 Governor's Budget Highlights)
- Attachment L—Budget Summary as of 2003-04 May Revision (page 97 of May Revision Report)
- Attachment M—2002-03 Cash flow as of 2002 Budget Act
- Attachment N—2002-03 Cash flow as of 2003-04 Governor's Budget
- Attachment O—2002-03 Cash flow as of 2003-04 May Revision
- Attachment P—Finance prepared spreadsheet comparing actuals to estimates. Actuals are from the SCO's Monthly Statement of General Fund Cash Receipts and Disbursement report.
- Attachment Q—SCO's Monthly Statement of General Fund Cash Receipts and Disbursements reflecting May actuals

cc: GAITHER, SHIMOMURA, FUJIWARA, SQUIRES, CHUNG-NG, LANDINGHAM, CHAVES, PAULIN, MOBLEY, MONROE, C/F, FILE



DEPARTMENT OF  
**FINANCE**  
OFFICE OF THE DIRECTOR

**MEMORANDUM**

**Date:** June 19, 2003  
**To:** Steve Peace, Director *ADS*  
**From:** Floyd Shimomura, Chief Counsel  
**Subject:** Vehicle Licensing Fee - Offset

Section 10754 of the Revenue and Taxation Code requires the Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD), as appropriate, to reduce Vehicle License Fee (VLF) offsets and restore the VLF during any period in which insufficient General Fund moneys are available to fully fund the offsets. As you know, in May we stated that based on all available financial information, it was anticipated there will be insufficient moneys available to be transferred from the General Fund for the offsets, beginning with the payments scheduled for transfer in July 2003. This conclusion was based, in part, on the most recent Statement of General Fund Cash Receipts and Disbursements.

The most recent financial information indicates that both the budget and cash tests for the operation of Section 10754 are met. Since the adoption of the 2002 Budget Act, the \$11.7 billion decline in the State's reserve far exceeds the amounts budgeted (i.e., \$3.9 billion) to fund the VLF offsets. Also, as of June 20, 2003, there will be insufficient moneys available to be transferred from the General Fund to fund the VLF offsets. (Finance memorandum dated June 19, 2003, "Vehicle License Fee Offset Suspension" and attachments.) On this date, the State must pay \$9.5 billion to retire a RAN obligation coming due. Thereafter, the State will be operating on cash derived from a \$10.965 billion RAW received on June 18, 2003, which will not be repaid until the following June. As Mr. Chivaro and I noted in our joint opinion dated March 7, 2003, "proceeds, or anticipated proceeds, of a RAW borrowing should not be counted in making the determination . . ." under Section 10754.

Accordingly, Section 10754 requires that the Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD) be informed that insufficient General Fund moneys will be available to fund any portion of the offsets starting on June 20, 2003. From this date, it will no longer be possible to certify that General Fund moneys are available for transfer to fund the offsets.