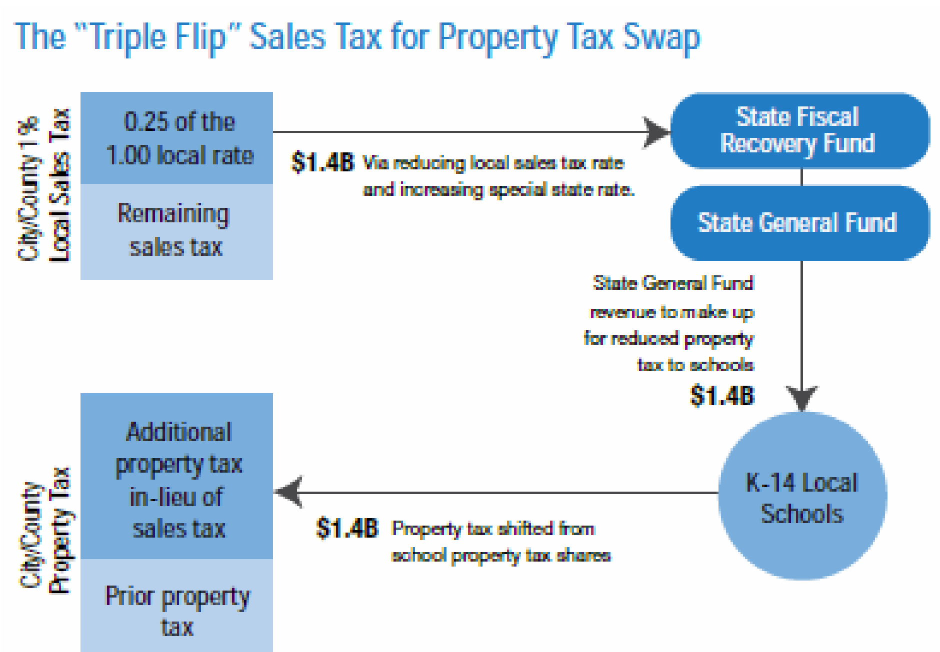
Unwinding the Triple Flip: The End is Near

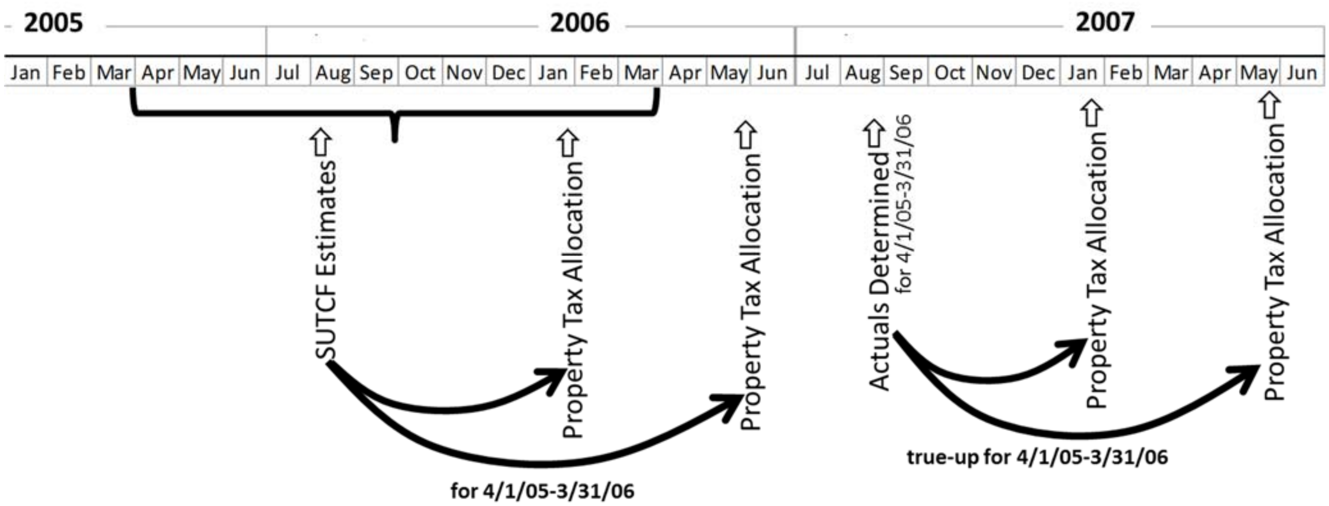
In March 2004, the voters of California approved Proposition 57, the California Economic Recovery Bond Act. The measure authorized the issuance of $15 billion in "Economic Recovery Bonds" to close the state's operating budget deficit. Under Proposition 57, the bonds are repaid from a dedicated 0.25 percent increase in the state sales and use tax. The city/county portion of the sales and use tax rate imposed Bradley-Burns Uniform Sales Tax law is reduced by 0.25 percent, such that there is no net impact on the total rate. Cities and counties are reimbursed for the reduced sales and use tax revenue with transfers of local property tax revenues that would otherwise have gone to schools. Schools are made whole from the state general fund and experience no negative impact. This mechanism is known as the "triple flip."



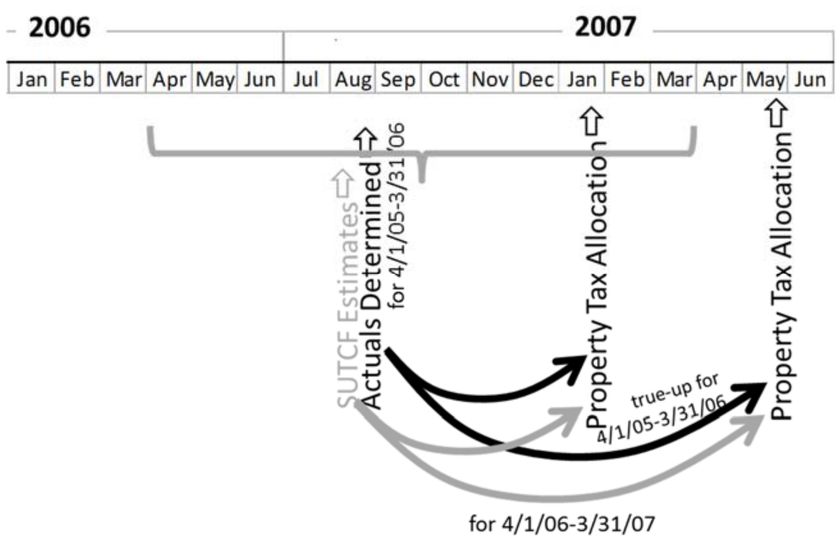
Triple flip reimbursements are allocated by county auditors from the Sales and Use Tax Compensation Fund (SUTCF) established in each county. No later than September 1 of each year, the state Department of Finance (DOF) provides each county auditor with the amount of the reimbursement due to each jurisdiction in the county for the coming fiscal year. DOF estimates are based upon the actual amount of sales and use tax revenues allocated to each jurisdiction in the prior fiscal year and any projected growth for the current fiscal year as determined by BOE. Each county auditor pays cities and the county from the county SUTCF fifty-percent in January, and fifty-percent in May.

Because the amounts provided by DOF for funding each SUTCF are estimates, there is a "true-up" adjustment each year to account for actual revenue collections. The "true-up" adjustment is added to or deducted from the SUTCF payment in the following year.

Triple Flip Compensation for FY2005-06, the April 1, 2005 – March 31, 2006 period



Triple Flip Estimates Paid for One Year Coincide with True-ups for the Prior Year

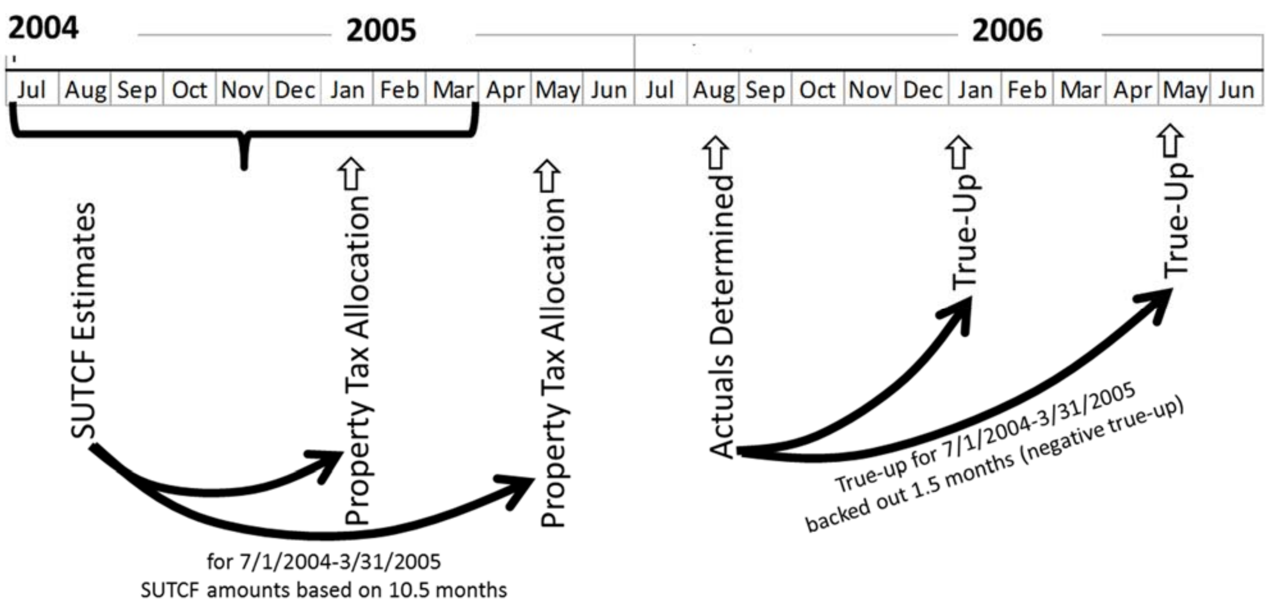


One Quarter Delay and the Nine-Month Beginning

In any given fiscal year, the triple flip payments from the SUTCF reimbursements cover the second third and fourth quarters of the first calendar year and the first quarter of the next. That is, for FY2005-06, the SUTCF payments were for estimated 0.25 percent Fiscal Recovery Fund amounts collected from April 1, 2005 through March 31, 2006. Thus, the reimbursements have been one quarter (three months) delayed since inception.

In the first year of implementation 2004-05, just 3 quarters (nine months) were reimbursed). The 0.25 percent flip began on July 1, 2004. For 2004-05 cities and counties were reimbursed for the July 1, 2004 through March 31, 2005 period (three quarters or nine months). This resulted in a small negative impact on cities of roughly 6 percent of annual total sales tax revenues, in implementation spread over two fiscal years.[1]

FY2004-05 First Year Was 3Qtrs (9Months) Compensation with Negative True-up in 2006



Economic Recovery Bonds Expected to Be Defeased in July 2015

The Department of Finance expects the Economic Recovery Bonds will be fully paid ("defeased") in July 2015. According to law, the full 1 percent local rate will then return on January 1, 2016 and the 0.25 percent state Fiscal Recovery Fund rate will end.

Final Years of the Triple Flip: FY2014-15

For the FY 2014-15 year, the triple flip will operate as it has in previous years. Estimates for the 4/1/14 – 3/31/15 flipped 0.25 percent were determined by Sept 1, 2014 and are being paid in January and May 2015. True up amounts for 4/1/13-3/31/14 period will also be paid at that time. In August, 2015, true up amounts for the 4/1/14 – 3/31/15 will be determined for payment with the January and May 2016 allocations. At this point, cities and counties should be fully reimbursed for sales and use tax lost from inception through March 31, 2015.

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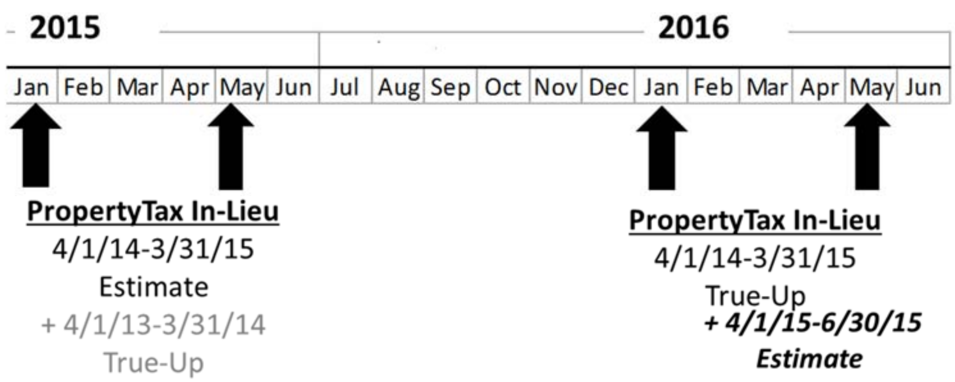
[1] For its 2004-05 SUTCF estimates, the DOF used a 10.5 month period, thus cities only experienced a negative impact of roughly one-half of one quarter of the 0.25 percent rate. In the true-ups for that year, implemented in January and May 2006 (thus experienced in the FY2005-06 year), the DOF directed a negative true-up for the 2004-05 period equivalent to 1.5 months, thus correcting the reimbursement to a 9 month period.

Final Property Tax in Lieu Payments from SUTCF Through 3/31/15



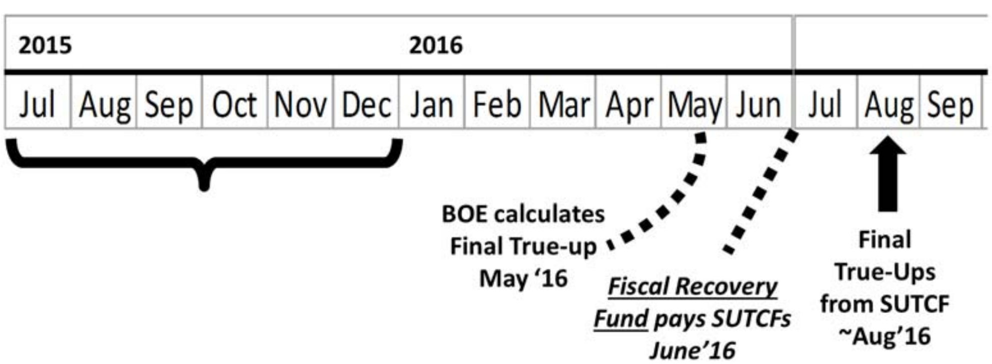
Second Quarter 2015: 4/1/2015-6/30/2015

In August, 2015, the DOF will provide county auditors with SUTCF amounts, based on BOE data, for the taxable sales in the 4/1/2015-6/30/2015 quarter. That is, the SUTCF amounts to be paid from property tax for FY 2015-16 in January and May 2016 will be for that one quarter only, not a full four quarters as in previous years. Therefore, January and May 2016 SUTCF payments will consist of estimated reimbursements for the 4/1/2015-6/30/2015 quarter and true-ups for the 4/1/2014-3/31/2015 prior four quarters. These are the last triple flip payments for which property tax will be the fund source to the SUTCF.

What's Left: 7/1/2015 – 12/31/2015 and 4/1/2015-6/30/2015 True-Up.

In May of 2016 the BOE will have sufficient information to calculate the compensation owed to cities and counties for the last two quarters of the triple flip (7/1/2015-12/31/2015). These amounts, together with true-up amounts for the 4/1/15-6/30/15 quarter will be paid from the state Fiscal Recovery Fund to county SUTCFs in June 2016. County auditors will make the final payments from the SUTCFs to cities and counties within 60 days. This will end the triple flip.

Final Triple Flip Compensation from the State Fiscal Recovery Fund in Aug 2016

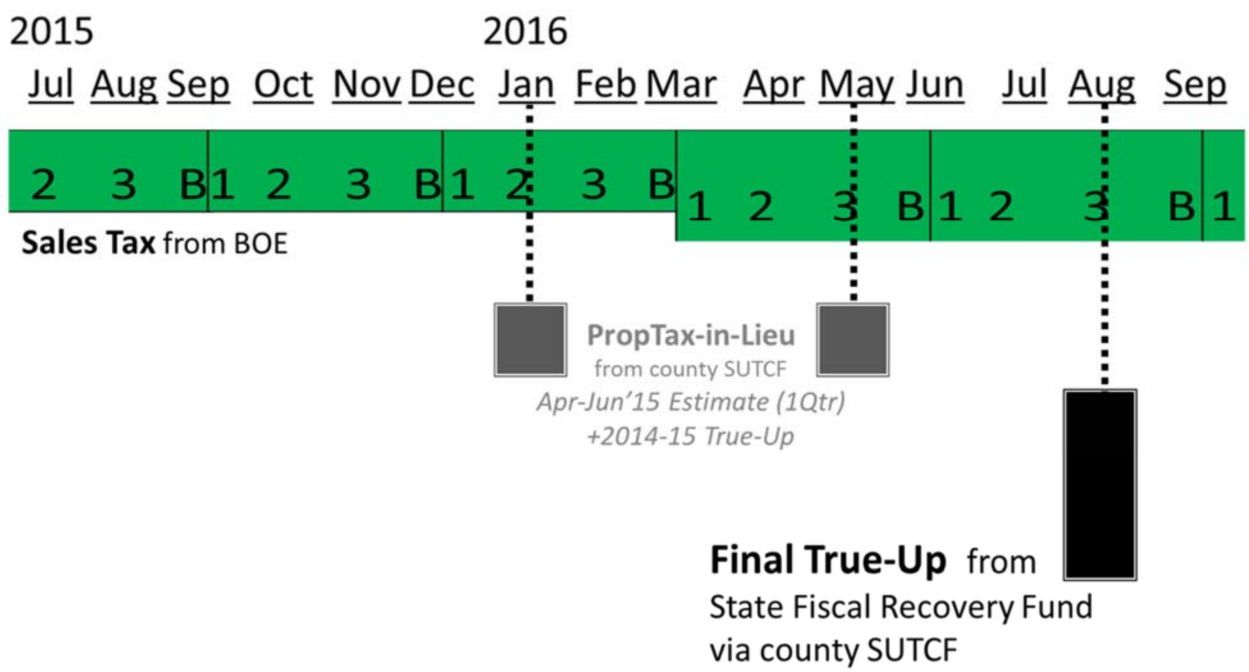


Putting the Cash Flow Together

Sales and Use Tax revenue distributions to local agencies follow a delayed schedule. Payments for a three month quarter are made in three monthly installments plus a true-up payment in the fourth month. So for the First quarter January-February-March, the payments are made in March (30% of estimate), April (30% of estimate), and May (40% of estimate) with a true-up based on actuals in June. Consequently, revenues from the full one percent local rate that begins on January 1, 2016, will begin appearing in city and county sales and use tax allocations in March 2016.

In January and May 2016, county auditors will distribute SUTCF allocations for the 4/1/15-6/30/15 quarter and 2013-14 true-up as directed. The final SUTCF true-up payments, covering the last two quarters of the triple flip, will be made in August 2016.

<u>FY2015-16 Sales Tax Cash Flows Including Final SUTCF payments</u>



A One Time Bump From The Catch-up and Overlap

Remember that triple flip reimbursements have been effectively one quarter (three months) behind since the beginning of the triple flip. Because of the overlap of the return of the full 1 percent rate and the delayed triple flip compensation, cities and counties will see a small increase in net sales tax revenues of roughly six percent in 2015-16, depending on accrual policies and the magnitude of true-ups.

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Triple Flip Unwind

Background:
As a result of the Triple Flip, the Bradley Burns rate was decreased from 1 percent to 0.75 percent on July 1, 2004, and a new 0.25 percent rate was established to create a dedicated revenue stream to repay the newly issued Economic Recovery Bonds (ERBs).

The ERBs are expected to be defeased in late July 2015. As a result, the 0.25 percent rate will revert back to the locals on January 1, 2016, increasing the Bradley Burns rate from the current 0.75 percent rate back to the original 1 percent. Also, the 0.25 percent rate that resulted in deposits into the Fiscal Recovery Fund to repay the Economic Recovery Bonds will turn off at the same time on January 1, 2016.

As a result of the above, the locals needed to be reimbursed for their sales tax lost from the 0.25 percent rate reduction from July 1, 2004 to December 31, 2015. The Triple Flip mechanism has been used each year to reimburse locals for their taxable sales from April 1 to March 31 of each year. The last Triple Flip letter issued on September 1, 2014 scheduled the reimbursement to the locals for the reduced sales tax rate on their taxable sales from April 1, 2014 to March 31, 2015. As such, once the second 2014-15 Triple Flip ERAF transfers have been made in May of 2015, counties and cities should have received the proper amount of tax reimbursement for taxable sales from July 1, 2004 through March 31, 2014, plus an estimated amount for taxable sales expected from April 1, 2014 through March 30, 2015.

The Unwind:

- For taxable sales April 1, 2015 – June 30, 2015, and for the true-up for taxable sales between April 1, 2014 and March 30, 2015, a partial year Triple Flip letter will be sent out by August 2015 to reimburse locals for the reduced sales tax rate. The Triple Flip payments will be made, per statute, ½ in January of 2016 and ½ in May of 2016.

- For taxable sales July 1, 2015 – December 31, 2015, as well as for the true-up for taxable sales between April 1, 2015 and June 30, 2015, BOE will provide DOF tax return data in May 2016. Once DOF has the final reimbursement schedule from BOE, DOF will issue a payment schedule to the Controller to reimburse locals.

- For taxable sales on and after January 1, 2016 the 0.25 percent will revert back to the original Bradley Burns tax rate. Counties and Cities will receive allocated payments directly from the BOE starting in March 2016 for quarter one 2016 taxable sales.

-California State BOE