February 19, 2008

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative "The California Renewable Energy and Clean Alternative Fuel Act" version 2, (A.G. File No. 07-0102, Amdt. #2-S).

Background

State Energy and Air Quality Programs. The state administers a number of programs to promote renewable energy, alternative clean fuels, energy efficiency, and air quality improvements. In addition to regulatory programs, these include programs that provide financial incentives for these purposes, such as grants, loans, loan guarantees, rebates, and tax credits. Funding for these programs has primarily come from fee revenues, although general obligation (GO) bonds have more recently been a funding source for air quality-related incentives programs.

State and Local Taxes and Local Vehicle License Fee (VLF) Revenues. State and local governments levy a number of taxes, including the sales and use tax (SUT). The SUT is levied on the final purchase price of tangible personal items, with a number of specified exemptions. The SUT has two rate components: the state SUT rate, which is currently 6.25 percent (of which 1 percent is distributed to local governments), and the local SUT rate, which currently varies between 1 percent and 2.5 percent, depending on the local jurisdiction. In addition, the state collects an annual VLF on motor vehicles, the revenues of which are distributed to cities and counties. Currently, the VLF rate is equal to 0.65 percent of a motor vehicle's depreciated purchase price.

Proposal

Authority to Sell GO Bonds. This measure allows the state to sell $6 billion in GO bonds for various renewable energy, alternative fuel, energy efficiency, and air emissions reduction purposes. Figure 1 summarizes available uses of the bond money, which primarily would fund financial incentives (1) to reduce the consumer cost of alternative fuel vehicle purchases and (2) for research, design, development, and deployment of renewable electricity generating technology. The measure allocates the bond funds among four accounts, as shown in the figure.

Figure 1

California Renewable Energy and Clean Alternative Fuel Act Uses of Bond Funds

(In Millions)

Clean Alternative Fuels Account	**$3,425**
• Rebates for alternative- and clean-fuel vehicle purchases ($2.85 billion) and for alternative fuel vehicle home refueling appliance purchases ($25 million).	2,875
• Financial incentives for research, development, and demonstration of alternative-fuel and high-efficiency vehicles, and alternative fuels.	550
Solar, Wind, and Renewable Energy Account	**$2,250**
• Financial incentives for research, design, development, construction, and production of electric generation technology that reduces generation cost and greenhouse gas emissions. At least 60 percent of the funds ($1.2 billion) must support financial incentives for solar technology.	2,000
• Financial incentives for equipment to produce electricity from renewable resources.	250
Demonstration Projects and Public Education Account	**$200**
• Grants to local governments for construction and operation of alternative and renewable energy demonstration projects.	200
Education, Training, and Outreach Account	**$125**
• Grants to public universities and colleges for staff development, training, research, and tuition assistance for alternative fuel and clean energy technology commercialization and workforce development. At least $25 million for outreach and public education.	125
Total	**$6,000**

State Agency Administration of Bond Funds. The measure designates various state agencies to administer different components of the measure. Specifically, the State Board of Equalization (BOE) would administer the alternative-fuel vehicle rebates, the Air Resources Board would administer the incentives for alternative-fuel research and development, and the Energy Resources Conservation and Development Commission would administer the renewable energy incentives and the monies available for grants to local governments and public higher education institutions for demonstration projects and public education. Regarding BOE's administration of the rebates, the measure provides that BOE shall calculate the SUT applicable to the sale or lease of a vehicle at the pre-rebate purchase or lease price.

The measure provides that each state administering agency is required to adopt program milestones, provide for annual independent audits, issue annual progress reports, and establish procedures for oversight of the awarding of incentives. The measure also provides that the monies allocated to each bond account are to be spent within 10 years, with reasonable efforts to be made to spend the monies for alternative-fuel vehicle rebates within five years.

Finally, the measure specifies that not more than 1 percent of the funds in each account established by the measure may be used to pay for program administration.

Fiscal Effect

Bond Costs. The cost of these bonds would depend on interest rates in effect at the time they are sold and the time period over which they are repaid. The state would likely make principal and interest payments from the state's General Fund over a period of 30 years. If the bonds were sold at an average interest rate of 5 percent, the cost would be about $11.7 billion to pay off both the principal ($6 billion) and interest ($5.7 billion). The average payment would be about $390 million per year.

Impact on State Sales Tax Revenues. The measure provides $2.875 billion for a variety of vehicle and appliance rebates. The rebates are designed to encourage the purchase of vehicles and appliances that, presumably, are more expensive than the vehicles and appliances that consumers would purchase in the absence of the rebates. To the extent the rebates result in consumers purchasing vehicles and appliances that are more expensive than those that they would otherwise purchase, state sales tax revenues would increase. In addition, consistent with experience with other product rebate programs, a portion of the bond funds provided by the measure for rebates could translate to corresponding increases in the sale prices of the products eligible for the rebates. (In other words, retailers may adjust the sales price upwards to account for the consumer being eligible for a rebate.) Such an increase in the sales prices of these products would result in an increase in state sales tax revenues. Finally, rebates will result in lower expenses for some consumers. If these consumers spend any of these savings on other taxable purchases, this will result in increased SUT revenues. While the exact amount of increased sales tax revenue that would result from the measure would depend on the quantity and actual selling price of vehicles and appliances purchased in response to the rebates, we estimate that the amount is potentially in the tens of millions of dollars over the lifetime of the measure.

Impact on Local Revenues. The bond-funded incentives programs under the measure would result in the following two effects on local revenues:

- ***Increased Local Sales Tax Revenues.*** As with the measure's impact on state sales tax revenues discussed above, depending on the quantity and actual selling price of vehicles and appliances purchased in response to the rebates, the measure would result in increased sales tax revenues to local governments, potentially in the low tens of millions of dollars over the lifetime of the measure.
- ***Increased Local VLF Revenues.*** As stated above, the measure is likely to result in consumers purchasing vehicles that are more expensive than those they would otherwise purchase. To the extent that the measure results in the purchase of more expensive vehicles than would otherwise be purchased, it would lead to increased local VLF revenues. While the exact amount of any such VLF revenue increase would depend upon the quantity and actual selling price of any vehicles purchased as a result of the rebates offered by the measure, we estimate the increase in VLF revenues to be potentially in the millions of dollars over the lifetime of the measure.

State Administrative Costs to Implement the Measure. The 1-percent limit the measure places on administrative costs, as described above, may leave the programs established by the measure with insufficient funds to implement these programs according to the measure. To the extent the measure fails to provide adequate funding for its administration, other state funds may face pressure, potentially averaging up to about $10 million annually, to fund implementation of the measure through about 2018-19.

Summary

In summary, the initiative would have the following fiscal effects:

- State costs of about $11.7 billion over 30 years to pay both the principal ($6 billion) and interest ($5.7 billion) costs on the bond. Payments of about $390 million per year.
- Increase in state sales tax revenues of an unknown amount, potentially totaling in the tens of millions of dollars, over the period from 2009 to beyond 2018.
- Increase in local sales tax and VLF revenues of an unknown amount, potentially totaling in the tens of millions of dollars, over the period from 2009 to about 2018-19.

- Potential state costs of up to about $10 million annually, through about 2018-19, for state agency administrative costs not funded by the measure.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael C. Genest
Director of Finance