Indian Gaming Special Distribution Fund Deficit

Fund Has Several Functions Under Tribal–State Compacts and Current Law

The Indian Gambling Special Distribution Fund (SDF) is a state–controlled account available for appropriation by the Legislature only for gambling–related purposes under the state's compacts with various Indian tribes. The compacts do not prioritize the use of SDF funds for these purposes. Chapter 858, Statutes of 2003 (SB 621, Battin), however, specifies the funding priorities for the SDF in the following order:

- Covering annual funding shortfalls in the Indian Gaming Revenue Sharing Trust Fund (RSTF), which distributes grants of $1.1 million per year to tribes that have no casino or only a small casino (with fewer than 350 slot machines).
- Programs that address problem gambling.
- Regulatory programs of the California Gambling Control Commission and the Department of Justice concerning tribal casinos.
- Grants to local governments to address the effects of tribal casinos on local infrastructure and public services.

Compacts Provide That Tribes Should Be Consulted on Local Grants. The state's compacts with tribes provide that it is the "intent of the parties" that the state's casino tribes "be consulted" in identifying uses for the local grants. Chapter 858 formalizes this consultation process by establishing a seven–member committee in each county with a tribal casino. Chapter 754, Statutes of 2008 (AB 158, Torrico), addresses certain findings in a 2007 report by the Bureau of State Audits that were critical of the local grant process and helped secure the Governor's approval in the bill (following an earlier veto) of a $30 million appropriation from the SDF for these grants in 2008–09. Chapter 754 also extends for one year—to January 1, 2010—an existing sunset date on the statutory local grant process.

Three Counties Receive Nearly Two–Thirds of All SDF Local Grants. Three Southern California counties—Riverside, San Diego, and San Bernardino—are expected to receive two–thirds of all SDF local casino grant funding in 2008–09. As we discussed in our February 2007 report, *Questions and Answers: California Tribal Casinos* (see page 6), the majority of the state's casinos and around one–half of the slot machines were located in these counties as of 2006. In addition, all of the amended compacts ratified by the Legislature and tribes in 2007 to allow for major casino expansions—those for the Agua Caliente, Morongo, Pechanga, and San Manuel tribes—are for tribes located in Riverside and San Bernardino Counties.

SDF Revenues Have Plummeted, Producing a Structural Deficit That Could Affect the General Fund in the Future

SDF Operations Through 2007–08 Produced Large Surpluses and Fund Balances. As we described in our February 2007 report, tribes make payments into the SDF based on a percentage of revenue from machines operated as of September 1999. In the first years after the state's 1999 compacts with tribes took effect, these tribal payments were sufficient not only to support SDF appropriations, but also to build significant surpluses. As shown in Figure 7, this fund balance accumulated to $192 million at the end of 2007–08.

Figure 7

Special Distribution Fund (SDF) Has Structural Deficit

(In Millions)

	2006-07	2007-08	2008-09 (Projected)	2009-10 (Budgeted)
Tribal payments to SDF and other minor revenues	$147	$103	$48	$47
Interest income	5	7	3	3
Total Revenues	**$152**	**$109**	**$51**	**$50**
Transfer to Revenue Sharing Trust Fund[a]	$47	$46	$39	$39
Office of Problem Gambling costs	3	3	8	8
Department of Justice costs	13	15	15	16
California Gambling Control Commission costs	5	7	10	9
Transfer to Charity Bingo Mitigation Fund	—	—	5	—
Local assistance grants	30	—	30	—
Other costs	<1	<1	<1	<1
Total Expenditures	**$98**	**$71**	**$108**	**$73**
Annual Surplus/(Deficit)	54	38	-57	-23
Ending Fund Balance[a]	153	192	135	112

[a] For 2009-10, the transfer to the Revenue Sharing Trust Fund (RSTF) listed in this figure is at the same level projected for 2008-09. To ensure that the amount budgeted for the transfer is sufficient each year, the budget bill lists a higher amount ($50 million in the *2009-10 Budget Bill*, for example) and provides that any portion of that amount not required to be transferred to the RSTF remains in the SDF. Because of this adjustment, the 2009-10 ending fund balance listed above is $11 million higher than that listed in administration documents.

Several Tribes With Large Casinos Have Stopped Paying Into the SDF. The current administration has negotiated several expansion compacts with tribes operating large casinos. In general, the recent compacts negotiated by the Governor and ratified by the Legislature have (1) ended required tribal payments to the SDF, (2) increased required tribal payments to the RSTF, and (3) increased significantly the required tribal payments to the state's General Fund and/or a state transportation account. In 2007, the Legislature ratified amended compacts with the Agua Caliente, Morongo, Pechanga, and San Manuel tribes, which these tribal governments subsequently approved. These amended compacts, collectively, have generated significant increases in tribal payments to the General Fund, but have resulted in *huge* declines in the SDF's annual revenues. As shown in Figure 7, the SDF collected $152 million of revenues in 2006–07—the last full fiscal year before the four amended compacts went into effect. In 2007–08—when the new compacts went into effect part of the way through the fiscal year—SDF revenues dropped to $109 million. For 2008–09 (the first full fiscal year under the new compacts), SDF revenues are expected to drop to $51 million. Barring any future changes in the state's compacts, SDF revenues should stabilize at about the $50 million level for the foreseeable future. Because of this revenue decline, the SDF now has a large, unsustainable structural deficit that must be addressed by the Legislature within the next few years.

How Many Years Before the SDF's Fund Balance Is Wiped Out? As shown in Figure 7, the SDF is projected to run a $57 million deficit in 2008–09. In 2009–10, the Governor's budget—which does not include funding for any local grants—would result in the SDF having a $23 million annual deficit by our estimates. If the Legislature again were to appropriate $30 million from the SDF for local government grants in 2009–10, the deficit would grow by the same amount—to $53 million. Accordingly, the length of time before the SDF's fund balance is completely depleted depends largely on the level of local grant funding paid from the fund. If the SDF were to run $23 million deficits each fiscal year, the fund balance could be depleted by the end of 2014–15. If, on the other hand, the SDF were to run $53 million deficits each fiscal year, the fund balance probably would be depleted by the end of 2011–12.

Dwindling SDF Balances May Affect General Fund in Future Years. Due to recent compact amendments, General Fund costs are now intertwined with the SDF's fiscal health. The General Fund has an obligation under three recent compacts to cover the RSTF annual shortfall if the SDF cannot. Using the SDF to backfill the RSTF, therefore, relieves the General Fund of that obligation. Furthermore, if the SDF's fund balances are depleted, the General Fund will be pressured to cover other existing expenses of the SDF.

Reforming Local Grants Could Target Scarce SDF Resources Better And Protect the General Fund

Grant Allocation Law Has Outlived Its Usefulness, Given Major Changes in the SDF. As noted above, Chapter 858 establishes the process for distributing local grants from the SDF. Chapter 858 was developed when the SDF was flush with revenues, paid in large part by tribes that, under recently amended compacts, no longer pay into the fund. Moreover, under the recent compact amendments, these tribes have separate obligations in some circumstances (such as expanding their casinos) to enter into enforceable agreements with local jurisdictions to mitigate the effects of their casinos on nearby communities. Given these recent changes in the SDF, we recommend that the Legislature use the opportunity provided by the January 2010 expiration of the existing local grant law to institute significant changes to the local grant process.

Changes Should Focus on High–Priority Local Needs and Reconsider Existing County–by–County Allocations. In particular, we recommend that the Legislature emphasize two key priorities in reforming the SDF local grant process:

- Ensuring that only the highest–priority local infrastructure, problem gambling, and public safety needs resulting from casinos receive funding.
- Ensuring that any county receiving mitigation payments from a tribe with a recently amended compact does not also receive substantial SDF grant funding related to that tribe. (It is likely that this approach would reduce the percentage of annual SDF local grant funding distributed to Riverside County and San Bernardino County.)

Following these priorities would distribute limited local mitigation resources to the communities near casinos with high–priority projects that lack other mitigation resources. Under our approach, tribal governments would continue to be represented on local grant committees, thus fulfilling the state's compact requirements to consult with tribes in distributing local grants.

Lower Amount of Annual Grant Appropriations Justified Based on Recent Compacts. As described above, several recently amended compacts provide for tribes to make mitigation payments to local governments in specified instances. Given these provisions, we believe it is appropriate to reduce annual statewide grant appropriations from the SDF to $5 million or $10 million per year. Over time, under the recently amended compacts, more tribes can be expected to pay local governments directly—instead of through the state–controlled SDF—to address their casinos' impacts on community infrastructure and services. Moreover, providing only $5 million or $10 million of appropriations from the SDF for local grants in each of the next few years—as opposed to the 2008–09 appropriation of $30 million—could preserve the SDF's fund balance for a longer period of time. This would delay the point in time when the General Fund may have to cover a portion of existing SDF expenses. Further, this approach is consistent with Chapter 858's listing of the local grants as the lowest–priority use of SDF dollars.

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