California Film & Television Tax Credit Program

Progress Report – July 2012

The California Film & Television Tax Credit Program (Program) was enacted in February 2009 as part of a targeted economic stimulus package to increase production spending, jobs and tax revenues in California. The Program has just commenced its 4th fiscal year. This report will summarize the Program's progress from its inception in July 2009 through June 2012, and includes spending estimates and project information for the current fiscal year (July 2012- June 2013). The report also includes a brief overview of California's entertainment industry and offers background on the heightened level of competition for our state's motion picture production spending.

The California Film Commission (CFC) administers the six year, $600 million program, which provides tax credits (beginning in tax year 2011) to eligible film and TV productions that meet specific criteria. The original legislation established a five year, $500 million program and was extended for an additional year in September 2011. The program targets those productions most likely to leave the state due to incentives offered by other states and countries. It has enabled California to be competitive and keep many at-risk projects in the state.

Enabling statute mandates the California Film Commission to allocate up to $100 million dollars in tax credits each fiscal year to eligible projects on a first-come first-served basis through FY 2013-14. If the amount of credits requested by applicants in any fiscal year exceeds the amount authorized for the program ($100 million), credits may be allocated from the next succeeding fiscal year. This provision enabled the CFC to allocate two fiscal year's worth of funding in the first year of the program. For all remaining fiscal year allocation periods, including the current fiscal year, the CFC may access only one year's funding. The statute also allows for any unallocated credits to roll forward to the next fiscal year's allocations.

Program regulations allow for allocations to be assigned based on a lottery if more than one application is received on any given day. At the beginning of each fiscal year, the CFC is flooded with hundreds of applications from independent and studio producers who want to produce their projects in California. The lottery system helps ensure tax credits are distributed as equitably and transparently as possible. Without the lottery, credits would be awarded on a first come, first served basis, which would enable one applicant with multiple project applications to dominate and receive a disproportionate amount of credits. The lottery mitigates such problems.

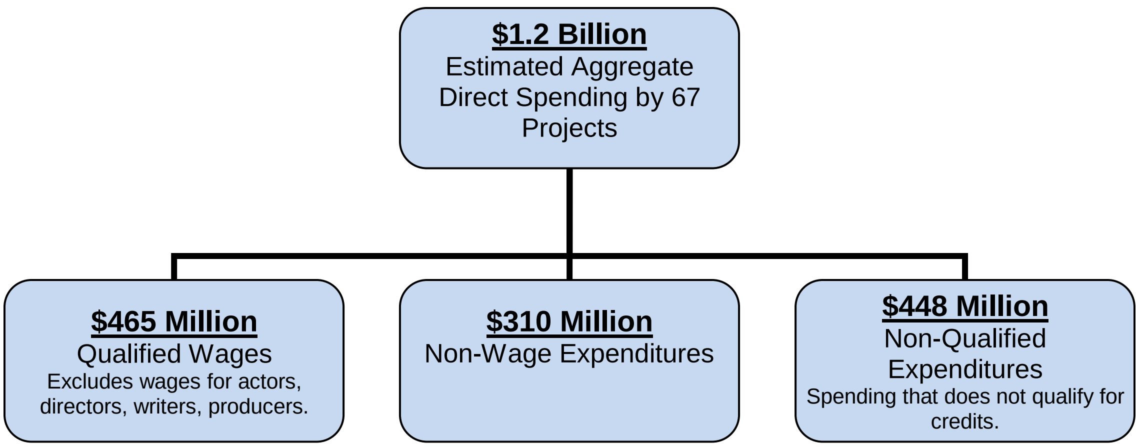
Productions do not receive their tax credit certificates until they have completed post-production and the CFC has reviewed all required documentation - including CPA audited cost reports. The statute also provides that no tax credits could be issued prior to January 1, 2011.

In late 2011, the tax credit program underwent an internal control review - a risk assessment performed by Business, Transportation and Housing Agency management. The assessment involved a review of the Program's lottery procedure, application review process, internal monitoring systems, database, and final document review. The CFC received a report on the testing process, in which it was praised for having the necessary mitigating controls for proper risk management of the Program. Business, Transportation and Housing management recommended creating and posting an application FAQ document. This new document was posted to the CFC website in January 2012.

Program Year 1 Summary (July 2009 – June 2010)

Program regulations were approved in June 2009, and the CFC began accepting applications on July 1, 2009. By the end of July, all $100 million in tax credits from FY 2009-10 were allocated. This initial allocation was treated as a “reservation” for tax credits. Due to the high volume of applications, the CFC then allocated credits from FY 2010-11. By January 2010, all 2010-11 tax credits had been exhausted. For the remainder of the fiscal year (through June 2010), the CFC maintained a waiting list for projects seeking tax credits.

When any approved productions withdrew from the program (due to a variety of causes – lack of adequate funding, schedule delays that pushed it beyond the program’s timeline requirements, casting issues, etc.), its credits were reassigned to projects on the waiting list. While $200 million in total was available as indicated on page 1, ultimately only $154 million was allocated to 67 projects for this fiscal year period. Some projects initially allocated credits withdrew and any remaining credits were rolled over into the next fiscal year’s funding. Program year 2009-10 impact is as follows:



Individuals Hired		
9,000 Crew Members	4,400 Cast Members	105,000 Background Players

Breakdown by Project Type						
	Feature Films	**TV Movies**	**TV Series**	**Relocating TV Series**	**Mini-Series**	**Total**
Number of Projects	46	13	6	1	1	67
Percentage of Credit Allocation	84 %	4 %	10 %	1 %	1 %	100 %

Independent VS. Non-independent Breakdown		
	Independent	**Non-independent**
Number of Projects	30	37
Percentage of Credit Allocation	12 %	88 %

Program Year 2 Summary (July 2010 – June 2011)

On June 1, 2010, the Film Commission began accepting applications for the FY 2011-12 allocation. These funds were available for allocation on July 1, 2010. Seventy applications were received on June 1st and credit allocations (reservations) were issued to 51 projects which exhausted the $100 million in funding available for the fiscal year. This was a mixed blessing in that the Program proved successful in achieving its objectives, but "sold out" in just one day. Over the course of the fiscal year, a total of 119 applications were submitted requesting credits for projects wishing to film in California. In total, $113 million in tax credits were allocated to 51 projects; the additional $13 million in credits rolled over from the previous year. Program year 2 impact is as follows:

$953 Million
Estimated Aggregate Direct Spending by 51 Projects

$296 Million
Qualified Wages
Excludes wages for actors, directors, writers, producers.

$248 Million
Non-Wage Expenditures

$409 Million
Non-Qualified Expenditures
Spending that does not qualify for credits.

Individuals Hired		
7,200 Crew Members	3,500 Cast Members	61,000 Background Players

Breakdown by Project Type						
	Feature Films	**TV Movies**	**TV Series**	**Relocating TV Series**	**Mini-Series**	**Total**
Number of Projects	26	12	11	2	0	51
Percentage of Credit Allocation	42 %	31 %	21 %	6 %	0 %	100 %

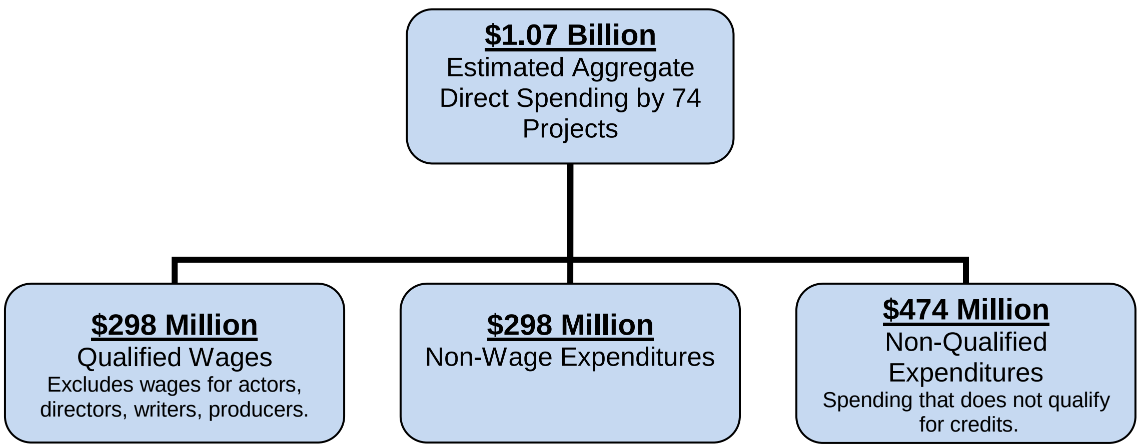
Independent VS. Non-independent Breakdown		
	Independent	**Non-independent**
Number of Projects	29	22
Percentage of Credit Allocation	14 %	86 %

For the remainder of the fiscal year, the Film Commission continued to manage the waiting list and monitor productions that inquired about tax credits but ultimately moved their productions out of state in order to access incentives offered elsewhere. Monitoring such activity has enabled the CFC to track some of the revenue that the state is losing (with the exception of lost revenues associated with productions that do not apply after learning that tax credit funds are already depleted). Data collection is ongoing and should be available in the 2013 Progress Report.

Program Year 3 Summary (July 2011 – June 2012)

On June 1, 2011, the Film Commission began accepting applications for the FY 2012-13 allocation. These funds were available for allocation on July 1, 2011. A total of 176 applications were received on the first day of the application period. Initially, on the first day that applications were accepted, 29 projects received conditional allocations exhausting the $100 million in available funding for Program Year 3 with the remaining projects placed on the waiting list. Once again, the program was oversubscribed in just one day.

As noted, occasionally projects issued an initial allocation will withdraw from the program due to a variety of factors – loss of financing, actor or director availability, project not able to begin filming within the program's mandatory 180 day period or other factors. When a project withdraws, those credits may be allocated to the next projects in line on the waiting list. During Program Year 3, several large budgeted projects withdrew and those available credits were re-assigned to many small budget independent projects. This resulted in an increase in projects from 29 initially to 73 by the end of the fiscal year. Ultimately, $127 million in tax credits were allocated as $27 million rolled over from the previous fiscal year. The estimated impact for Program Year 3 is as follows:



Individuals Hired		
8,500 Crew Members	3,900 Cast Members	80,000 Background Players

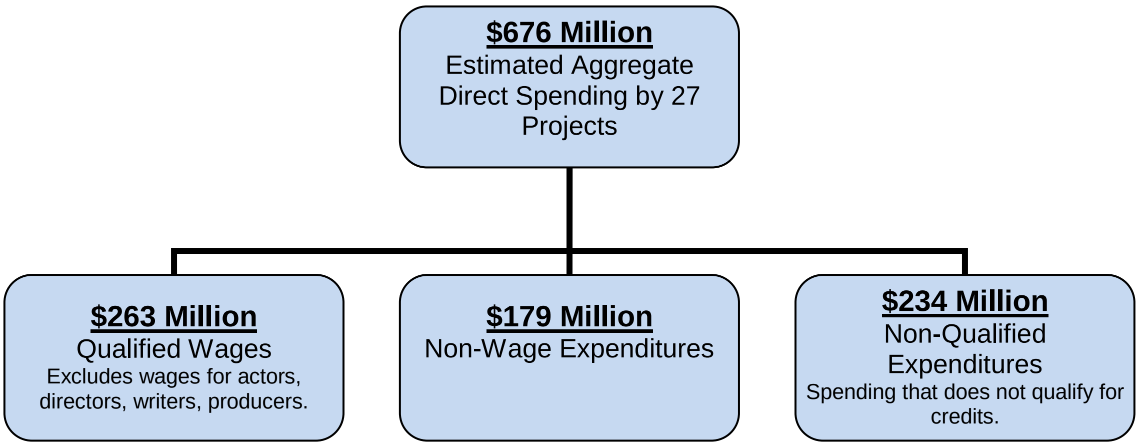
Breakdown by Project Type						
	Feature Films	TV Movies	TV Series	Relocating TV Series	Mini-Series	Total
Number of Projects	51	13	8	1	0	73
Percentage of Credit Allocation	66 %	6 %	27 %	1 %	0 %	100 %

Independent VS. Non-independent Breakdown		
	Independent	Non-independent
Number of Projects	53	20
Percentage of Credit Allocation	36 %	64 %

Program Year 4 Summary (July 2012 – June 2013)

This year, on June 1, 2012, the CFC began accepting applications for the FY 2013-14 allocation. (Funds may not be allocated until the beginning of the fiscal year on July 1, 2011.) A record 322 applications were received on the first day of this application period. Credit allocations (reservations) have been conditionally issued to 27 projects[1]. As in past years, the program was oversubscribed and all funding was exhausted in just one day. The remaining applications were placed on the waiting list and the CFC will continue to receive applications throughout the fiscal year. To date, there are 304 applications on the waiting list.

As noted in previous years, some projects issued an initial allocation will withdraw from the program freeing up some credits for allocation to projects that are currently on the waiting list. To date, $100 million in tax credits have been conditionally allocated to 27 projects. The preliminary estimated impact for Program Year 4 is as follows:



Individuals Hired		
2,800 Crew Members	2,900 Cast Members	57,000 Background Players

Breakdown by Project Type						
	Feature Films	**TV Movies**	**TV Series**	**Relocating TV Series**	**Mini-Series**	**Total**
Number of Projects	10	4	10	2	1	27
Percentage of Credit Allocation	11 %	3 %	62 %	23 %	1 %	100 %

Independent VS. Non-independent Breakdown		
	Independent	**Non-independent**
Number of Projects	13	14
Percentage of Credit Allocation	12 %	88 %

[1] Some Program Year 4 applications are still under review.

The CFC will continue to track the status of projects on the waiting list and capture information including whether or not the project was made, where it was made and whether or not it received an incentive in its chosen locale. Using data provided by the applicants, the CFC will quantify the loss of production spending if and when any of these productions leave the state.

While a small number of submitted projects that do not receive an incentive still film in the state, available data show that the ones that remain are small, low-budget films, while the larger budget films with the potential to create thousands of jobs, leave for states or other countries with incentives.

Aggregate Spending and Economic Impact

To date, approximately $500 million in tax credits has been allocated (reserved), resulting in:

- Estimated total aggregate direct spending by Program projects: $3.9 billion

- Estimated total qualified wages paid / to be paid by Program projects: $1.3 billion

In June of 2011, the Los Angeles Economic Development Corporation (LAEDC) released a study to determine the economic impact of the tax credit program. The study analyzed the first 77 productions approved for tax credits totaling nearly $200 million. The executive summary states:

> *"During the first two years of the program, California's Film and Television Tax Credit has generated more than $3.8 billion in economic output and is supporting more than 20,000 jobs in California.*
>
> *For every tax credit dollar approved under California's Film and Television Tax Credit program, at least $1.13 in tax revenue will be returned to state and local governments.*"

The full study is available at: http://www.film.ca.gov/2011_Reports_&_Studies.htm

In Feb. 2012 another report (conducted by The Headway Project in collaboration with the UCLA Institute for Research on Labor and Employment) for the most part validated the methodology and results as reported in the earlier LAEDC report. The Headway report made adjustments, based on some newer data, and determined that for every dollar in tax credits issued $1.04 in state and local tax revenues will be returned - rather than $1.13 as indicated in the LAEDC study. A reduction from the original report yet still indicates a positive return on investment. For the full report see:
http://www.headwayproject.org/downloads/Headway_Entertainment_Report.pdf.

The Los Angeles region experienced a steady decline in feature film production days in 11 of the last 14 years. However, Film L.A. (the Los Angeles region's film permitting agency) which tracks filming trends in the Los Angeles region reported that incentivized feature films drove the rise in feature film shooting days in the region. In 2010, feature film production posted a year-over-year gain of 8.1 percent.

> "*The annual increase can be wholly attributed to California's Film and Television Tax Credit. The State program attracted dozens of new feature film projects to Los Angeles, which were responsible for 26 percent of local feature production for the*

year. Were it not for these projects, 2010 would have been the worst year on record," Film L.A. reported in its Jan. 11, 2011 release.

These numbers are a valuable early indicator that the incentive program has had an immediate impact on production levels.

In their Jan. 2012 release of 2011 production statistics, Film L.A. reported that on-location Feature production increased 5.7 percent for the year. "*The California Film & Television Tax Credit Program did its part to keep Features in positive territory in 2011, as state-qualified Feature projects generated 652 PPD (production days) in the L.A. region last year -- 11.5 percent of the annual total.*"

In the same report, Film L.A. found that the Los Angeles region lost production of ten one-hour TV Drama series to other states, notably New York, which had a record television season due to its film incentives that provide $420 million in annual tax credits. In 2011, TV Drama production days decreased by 11.5 percent in Los Angeles. (Note: network dramas are not eligible for the California tax credit.) More recently, in July 2012, Film L.A. reported a 15.4% drop for TV production days in the second quarter of 2012, noting the region continues to lose TV Drama productions to other North American locations.

Economic Impact to Local Regions

While most production activity occurs in the greater Los Angeles area, other regions across the state have seen significant economic impact from tax credit program productions. A sampling of production spending impact outside Los Angeles includes:

- Alameda County: In 2010, a feature film shooting for one week in the Oakland area was responsible for a total of $1,708,000 in local spending (including $662,000 in local wages, $200,000 at local hotels and $201,000 for food/catering).

- Kern County: In 2009 and 2010, two feature films shot for several days in Kern County. These productions were responsible for a total of $243,000 in local spending ($68,000 in local wages, $111,800 at local hotels and $9,800 for food/catering).

- Placer County: In 2010, a feature film shot for several days in Placer County. This production was responsible for a total of $79,000 in local spending (including $5,700 in local wages, $20,000 at local hotels and $3,400 for food/catering).

- Riverside County: In 2011, a feature film shot for two weeks in Riverside County resulting in $251,000 in local spending (including $16,000 in local wages, $59,000 at local hotels, $41,000 for food purchases.)

- Santa Barbara County: In 2011, two feature films shot in Santa Barbara and were responsible for more than $410,000 in local spending (including $57,000 in local wages, $68,000 at local hotels and $71,000 in location fees).

- San Bernardino County: In 2010, a feature film that shot for 12 days in San Bernardino was responsible for $626,000 in local spending (including $87,000 in local wages, $321,000 at local hotels and $28,000 for food/catering).

- San Diego County: In 2009-2010, a television series based its production in San Diego County and was responsible for a total of more than $16 million in local spending during the course of its season ($10,508,000 in local wages, $521,000 at local hotels and $387,190 for food/catering).

- San Francisco: In 2011, the Bay Area hosted a TV movie that filmed for 47 days, an independent feature that filmed for 22 days and portions of a TV series. Together, these productions were responsible for more than $18.4 million in local spending (including $8,800,000 in local wages and $294,000 for food/catering).

- Ventura County: In 2010 and 2011, several feature films shot extensively in Ventura County including *We Bought a Zoo* and *Water For Elephants*. These productions were responsible for a total of $6,438,000 in local spending including $2,840,000 in local wages, $153,000 at local hotels, $142,000 for food/catering and $1,036,000 for location fees.

Issuance of Tax Credit Certificates

As mentioned previously, productions do not receive their actual tax credit certificates until they have completed post-production and the California Film Commission has reviewed all required documentation - including CPA audited cost reports. As per the statute, no credits were issued prior to January 1, 2011. Because of varying production schedules, applicants typically submit the final documentation required to receive tax credit certificates 12 – 24 months after they receive their initial allocation letter. The Film Commission issues the certificates within 15 business days of receiving final documentation.

Total tax credit certificates issued to date: $184,217,373 to 88 applicants.

- As of June 2012, no credits were claimed against sales & use taxes.
- As of June 2012, total tax credits claimed against income tax liability: $229,139.

Recent and Pending Legislation

SB X3 15 (Calderon) / ABX3 15 (Krekorian) was enacted in 2009 creating the California Film and Television Tax Credit Program which provided a five-year, $500 million tax credit program to be administered by the California Film Commission.

AB1069 (Fuentes) was enacted in Oct. 2011 and provided a one-year extension to the California Film & Television Tax Credit Program through FY 2014-15. The original bill was seeking a five-year extension but was reduced to one-year in the Senate.

AB2026 (Fuentes) was introduced on Feb. 22, 2012. The bill seeks a five-year extension to the California Film & Television Tax Credit Program through FY 2019-20.

SB1167 (Calderon), also introduced on Feb. 22, 2012. The bill seeks a five-year extension to the California Film & Television Tax Credit Program through FY 2019-20.

Global Competition for California's Motion Picture Production

Today's business model for motion picture production continues to rely on tax incentives as a way to lower production costs. Financing for projects by independent production companies now requires the monetization of tax credits in order to raise necessary funds. Without incentives, most independent projects would not be produced. Therefore, the availability of tax credits has become the determining factor when it comes to where the vast majority of projects are filmed. In addition to international competition from Canada, Australia, the U.K. and most EU nations, more than 40 U.S. states offer financial incentives to lure production and post-production jobs and spending away from California.

Once such incentives take root, other states and countries effectively develop their long-term infrastructure with stage construction, post-production facilities and job training programs. For example, incentive-rich jurisdictions such as New Mexico, Louisiana, Philadelphia, Michigan, Toronto and Hungary have all recently built impressive multi-studio facilities.

While production companies will relocate their relatively small creative teams (producers, actors, directors, writers) to another state for the duration of the film shoot, very few production crew members (drivers, camera technicians, carpenters, make-up artists) will be hired from California. The few that are hired to work out of state on location will pay income tax in the work state. Skilled California crew members end up training the local workforce so that fewer California workers are needed on subsequent film shoots. This has helped to create a pool of skilled local crews around the country and around the world.

As a consequence, California is losing market share of film and television production spending. Each year competing states that offer incentives experience dramatic growth in production spending – siphoning money that would have historically been spent in California. Recently, Louisiana announced that production spending there topped $1 billion in 2011. That was a nearly *25,000 percent* increase since they introduced their incentive in 2003.

The July 2010 Milken Institute report titled, *Film Flight: Lost Production and Its Economic Impact on California,* stated, "There's no doubt that incentives have been drawing jobs and wages away from California." The report estimates that California's movie industry lost 10,600 direct jobs and 25,500 indirect jobs since its peak employment level in 1997.

California's Motion Picture Industry

General Overview:

- The motion picture industry is an essential source of economic activity, tax revenue, jobs and tourism in California. It contributes $30 billion dollars annually to our state's economy while supporting 174,000 well-paying entertainment industry jobs that provide health benefits. (Source: Employment Development Department and Motion Picture Association of America – MPAA)

- The average shooting cost for a feature film or TV series ranges from $100,000 to $250,000 per day. That's actual dollars that each production spends on wages, groceries, hotel rooms, gas, building supplies, props, payroll, etc.

- A typical film shooting outside of Los Angeles County will spend an average of $50,000 per day in the local community. (Source: Association of Film Commissions International - AFCI)

- The average annual salary for production employees is $75,000 -- well above the national average. (Source: MPAA)

- This industry is dominated by small businesses – 80% of entertainment companies employ fewer than 10 people. (Source: MPAA)

- An average $70 million dollar feature film generates $10.6 million in state sales and income taxes. (Source: Los Angeles Economic Development Corp)

- The motion picture industry is the fifth highest ranking employer in southern California. (Source: Los Angeles Economic Development Corp. - LAEDC)

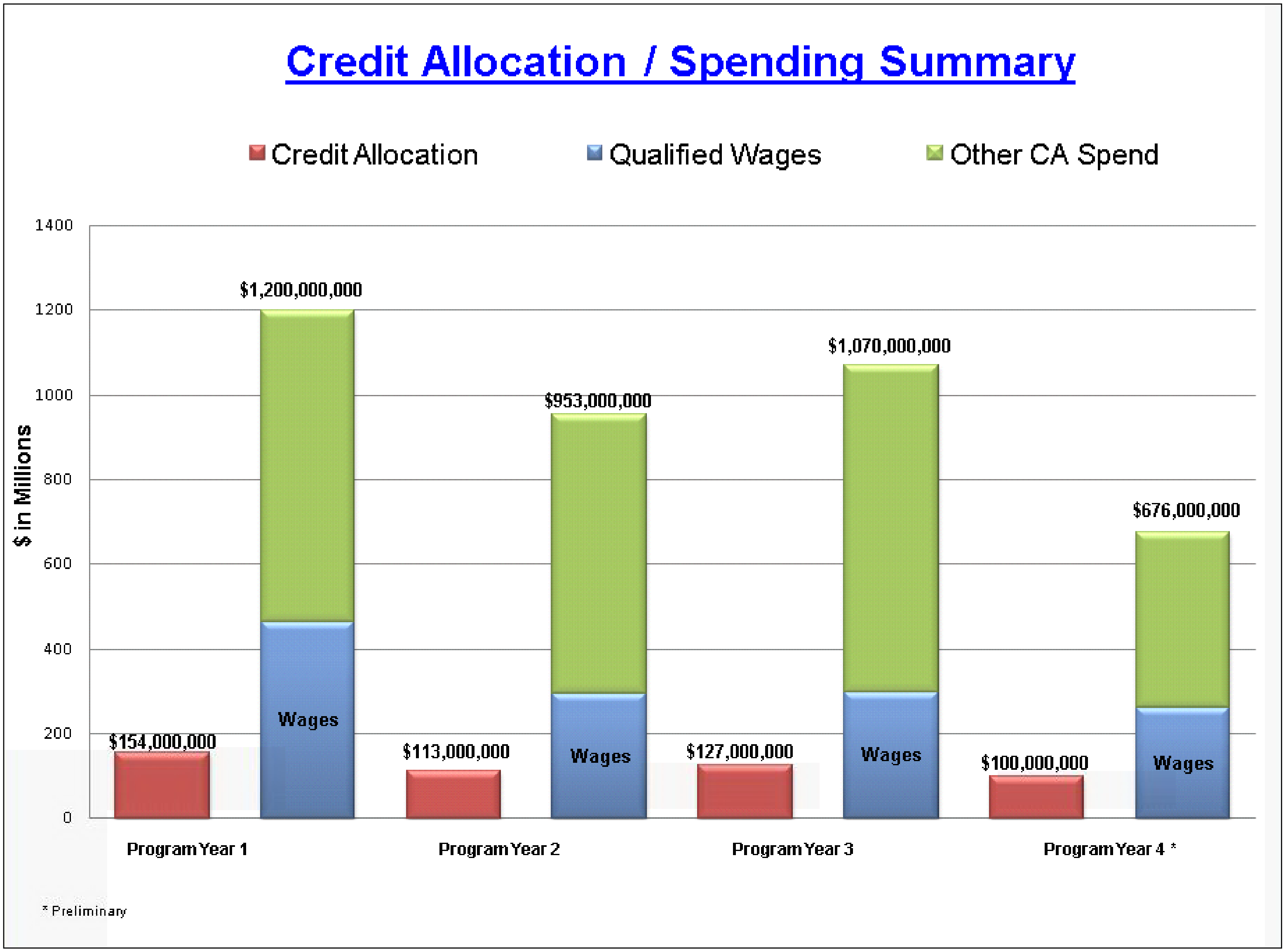
- Film and TV production brings millions of tourists to California each year.

Conclusions

While California still boasts a superior critical mass of state-of-the-art facilities and highly-skilled film crews, this infrastructure is eroding steadily. Entertainment industry unions report high levels of unemployment among their members in the Golden State. Many production facilities in California have closed or been forced to lay off employees, while others have expanded their businesses out of state rather than investing at home. Many film industry workers and service providers report devastating income losses due to the large number of feature films and TV series relocating to other jurisdictions.

It is clear that demand for California tax credits far exceeds supply. Without adequate funding for the tax credit program, California will continue to lose direct spending and tax revenues from film and TV productions that choose to film elsewhere. The situation is especially dire for production of television series, given that producers are unlikely to film their first season in California without the expectation that tax credits will be available for future seasons.

The California Film and Television Tax Credit program was designed to target those productions most at risk of leaving the state, while working within the annual funding limits due to state budget constraints. The program has succeeded in attracting this target group: basic cable TV series, mid-sized feature films and made-for-TV movies. Even with this narrow target of potential applicants, demand exceeds supply (note: California's tax credit program excludes big-budget feature films and broadcast network TV series). In order to retain and grow California's signature entertainment industry, the state must be competitive. Otherwise, productions will increasingly choose to base their film shoots in other states and countries.



Credit Allocation / Spending Summary
Credit Allocation
Qualified Wages
Other CA Spend
$ in Millions
1400
1200
1000
800
600
400
200
0
$1,200,000,000
$953,000,000
$1,070,000,000
$676,000,000
$154,000,000
$113,000,000
$127,000,000
$100,000,000
Wages
Wages
Wages
Wages
Program Year 1
Program Year 2
Program Year 3
Program Year 4 *
* Preliminary