Senate Budget and Fiscal Review—Holly J. Mitchell, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Scott Wilk

Thursday, March 30, 2017
9:30 a.m. or upon adjournment of Session
State Capitol – Rose Ann Vuich Hearing Room (2040)

PART B

Consultant: Mark Ibele

ITEMS FOR DISCUSSION AND VOTE

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ISSUES PROPOSED FOR DISCUSSION AND VOTE

PROPOSITION 2 PROPOSAL

Issue Overview. Proposition 2, which revised the state's Budget Stabilization Account (BSA), was approved by the voters in November 2014. The measure changes the way the state pays down debts and liabilities, as well as how it sequesters money in reserves. According to the Legislative Analyst's Office (LAO), Proposition 2 could result in roughly $15 to $20 billion being used to pay down certain state debts through the duration of the measure's debt payoff requirement. Calculations made under Proposition 2 determine the amount of funds that are split evenly between the BSA and debt pay-down. Payments on the state's debts and liabilities represent budget choices, as payments on these restrict legislative discretion and displace funding for ongoing or expanded program costs.

Issue 1: Debts Eligible for Proposition 2 Payments

Governor's Proposal. Under the Administration's calculations, Proposition 2 captures a total of $2.4 billion in the budget year. Proposition 2 requires that this amount be split evenly between paying down existing state debt and deposits to the reserve. The Governor proposes to spend the required $1.2 billion on paying down $252 million in special fund loans, $400 million in prior-year Proposition 98 costs known as "settle-up" and $235 million in transportation loans. In addition, the Governor's plan would use $100 million for state retiree health and $169 million for University of California employee pensions. The Administration's multi-year budget plan proposes to fully repay transportation loans by 2019-20, and payoff special fund loans and Proposition 98 settle-up by the end of 2020-21. Due to the dynamic nature of budgeting and changing fiscal circumstances, the pay-off schedule always changes somewhat from year to year. Detail on the Governor's current plan is displayed in the table below.

Proposal for Debts and Liabilities Payments
(Dollars in Millions)

Category	Amount Beginning of 2017-18	Payment in 2017-18
Budgetary Borrowing		
Special Fund Loans and Interest[1]	$1,365	$252
Proposition 98 Settle-Up Underfunding[1]	1,026	400
Transportation Loans (Pre-Proposition 42)[1]	706	235
Subtotal Debt	**$3,097**	**$887**
Retirement Liabilities		
State Retiree Health[1]	74,103	100
State Employee Pensions	49,592	0
Teacher Pensions	72,626	0
Judges' Pensions	3,279	0
CalPERS Deferred Payment	627	0
UC Employee Pensions[1,2]	15,141	169
UC Retiree Health[2]	21,087	0
Subtotal Liabilities	**$236,455**	**$269**
Grand Total	**$239,552**	**$1,156**

[1] Payment under Proposition 2.
[2] Not a state government liability.

The special fund loans (other than the transportation loan categorized separately above) that would be repaid under the Governor's budget are shown below.

Governor's Proposal for Repayment of Special Fund Loans
(Dollars in Thousands)

Fund Name	Amount
Greenhouse Gas Reduction Fund	100,000
Immediate and Critical Needs Account	90,000
Hospital Building Fund	15,000
False Claims Act Fund	12,700
Contingent Fund of the Medical Board of California	9,000
Behavioral Science Fund	6,300
Firearms Safety and Enforcement Special Fund	4,900
Registry of Charitable Trust	2,700
Environmental Water Fund	2,400
California Water Fund	1,100
Total	**$244.1**

Background. Through budget actions over the last decade, the state borrowed from special funds, deferred various payments to schools and other entities, and took certain other actions in order to help balance the state budget. By the close of 2010-11, the Department of Finance (DOF) indicates that a total of $34.7 billion in loans and deferrals had accumulated and remained unpaid. This amount largely represents the debt overhang from prior year budgets adopted under the previous Administration and was formerly referred to as the "wall of debt." The DOF no longer formally calculates the "wall of debt"; however, the amount formerly included in this calculation is expected to be reduced to a total of about $3.1 billion by the inception of 2017-18.

Some of these obligations have required repayment in specified years due to constitutional requirements or due to scheduled bond debt service. Other debt payments are more flexible and can be repaid over time depending upon the budget condition, as long as borrowing does not interfere with the activities that a special fund loan supports. The General Fund is typically used to pay off budgetary debt. In addition to these budgetary obligations, the state has accumulated liabilities for retirement costs for state employees, teachers, judges, and University of California employees. These latter liabilities will total an estimated $236.5 billion at the start of 2017-18. Some of these unfunded liabilities are being addressed with routine annual payments over time.

Legislative Analyst's Office Comments. In its analysis the LAO notes options that would create additional General Fund flexibility. First, it indicates that weight fee loans could be considered loans under the Proposition 2 'eligible debt' definition. If the amounts owed under this loan were repaid under the Proposition 2 debt umbrella – as opposed to using General Fund as the Governor proposes – this would free up $380 million in General Fund resources on a one-time basis. Second, the LAO notes that the recent change in the investment return, enacted by CalPERS and STRS, resulted in an annual increase in the state's contribution rates and a corresponding increase over the base payment amounts incorporated in Proposition 2. It is possible – although uncertain – that the difference between the base amount and the increased requirement would be eligible for Proposition 2 debt repayment. This approach could potentially result in additional unspecified General Fund room of a few hundred million dollars, according to the LAO.

Staff Comment. The Governor has prioritized using Proposition 2 funds to pay off special fund loans and prior-year Proposition 98 settle-up obligations. However, alternative uses of these funds could pay down certain liabilities faster or potentially free up General Fund dollars for other purposes. For example, prior years highlighted the $74 billion unfunded liability for retiree health care costs. The Governor has instead pursued a plan – to this date, largely successful – substantially reliant upon employee bargaining to eliminate the unfunded liability over a 30 year period. While the Administration could have used more of the Proposition 2 funds to pay down some of the retiree health care unfunded liability, the Governor proposes to begin working down this debt with a relatively minor initial commitment of $100 million, which then ratchets up to reach $300 million in 2020-21.

In addition, the state could pay off more or less special fund loans now than the Governor proposes. Some of the loan repayments proposed are fiscally necessary and some of the loans could be repaid to help meet the desired program objectives; however, some repayments are unnecessary to make at this time, as the programs have been operating for many years without the funds. While working down the smaller amounts of special loan repayments cleans up the state's balance sheet, augmenting resources devoted to pension liabilities sooner can have a substantial impact on future state liabilities. In addition, the LAO notes two alternative approaches to Proposition 2 debt payments which are worthy of consideration. In any event, the loans and amounts for repayment are likely to change in the May Revision and any action would be premature at this time.

Staff Recommendation. Hold open.

Vote:

8885 COMMISSION ON STATE MANDATES

Department and Issue Overview: The Commission on State Mandates (CSM) is a quasi-judicial body created for the purpose of determining state-mandated costs. The objective of the CSM is to impartially hear and determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state, consistent with Article XIII B, Section 6 of the California Constitution. The CSM consists of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, and a public member and two local government representatives appointed by the Governor and approved by the Senate.

The CSM is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution.

In prior years, there have been proposals to repeal certain mandates, but no such repeal is proposed in the budget. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code, improves statutory transparency, and provides more certainty to local governments.

Issue 1: Funded and Suspended Mandates

Governor's Proposal. The proposed funding for non-education mandate payments to local governments is included in the budget of CSM. The Governor's mandate proposal is largely a continuation of the status quo in terms of mandates in effect (funded) and mandates not in effect (suspended). The budget proposes expenditures of $34.5 million related to funding non-education mandates. The budget would continue to fund the 19 mandates that were kept in force for 2016-17, the payments on which constitute the bulk of the General Fund cost. Most mandates funded in the budget concern public safety or property taxes. Funded mandates are listed in the following table.

Mandate Funding in Governor's Budget
General Fund
(Dollars in Thousands)

Mandate Title	Amount
Accounting for Local Revenue Realignments	$ 97
Allocation of Property Tax Revenues	570
California Public Records Act	-
Crime Victims' Domestic Violence Incident Reports	164
Custody of Minors-Child Abduction and Recovery	12,555
Domestic Violence Arrest Policies	7,756
Domestic Violence Arrests and Victims Assistance	1,896
Domestic Violence Treatment Services	2,379
Health Benefits for Survivors of Peace Officers and Firefighters	2,413
Local Agency Ethics	5
Medi-Cal Beneficiary Death Notices	14
Medi-Cal Eligibility of Juvenile Offenders	3
Peace Officer Personnel Records: Unfounded Complaints and Discovery	678
Post Election Manual Tally	-
Rape Victim Counseling	444
Sexually Violent Predators	3,693
Sheriff Court-Security Services	803
State Authorized Risk Assessment Tool	629
Threats Against Peace Officers	1
Tuberculosis Control	97
Unitary Countywide Tax Rates	313
Total	**$34,510**

The budget incorporates a total of $985.1 million in savings from maintaining mandate suspensions or deferring payment of claims. Some 56 mandates are suspended under the budget proposal. In addition, payments on another 21 mandates that have been deferred or have expired have been delayed. The savings breakdown is as follows: (1) $284.1 million savings from deferring payment of post-2004 mandate claims for mandates that have since expired or are otherwise not in effect; (2) $596.1 million savings by continuing the suspension of certain local mandates; and, (3) $104.9 million savings from deferring payment on employee-rights mandates in effect.

Staff Comment. Revisions to the mandate process that would provide more certainty to the Legislature and local governments should be a priority for the policy process. The existing procedures fall short in terms of clarity, transparency and effectiveness. However, given the current system, the Governor's proposal is reasonable.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 2: Election Mandates

Budget Issue. The state currently has in place six local government mandates that govern the conduct and activities associated with state and local elections. The first of the activities determined to be a mandate was adopted in 1975, and the most recent mandate was adopted in 2009. Three of the six mandates have been suspended in the budget (and thus not required to be conducted by local governments) since 2011, and the remaining three were suspended beginning in 2013. The Governor's budget proposes to continue the suspension of all six election mandates.

Under legislation adopted along with the 2015 Budget Act, the Department of Finance (DOF) was required to submit a report to the Legislature regarding the funding of the election mandates. The language in SB 84 (Committee on Budget and Fiscal Review), Chapter 25, Statutes of 2015, states:

> *"The Department of Finance, in collaboration with the Secretary of State and the Legislative Analyst's Office, shall convene a working group to evaluate alternatives for funding election-related mandates. The working group shall commence no later than September 1, 2015. By September 1, 2016, the Department of Finance shall submit to the Legislature a report that summarizes the findings of the working group, including recommendations to the Legislature."*

The report was provided to the Legislature in October of 2016. Prior to 1979 and the passage of Proposition 4, local election officials primarily used property tax revenues to pay for election costs. After that, local governments typically have submitted claims for the reimbursement of election costs associated with mandates imposed by legislation. As noted above, Proposition 1A requires the state to either fund or suspend local mandates, including those associated with elections. The six election mandates are:

- **Absentee Ballots.** Requires that absentee ballots be available by election officials to any registered voter.

- **Absentee Ballots – Tabulation by Precinct.** Requires that an election official's listing of absentee voters include the voter's precinct.

- **Modified Primary Election.** Requires voter registration cards to include a notice to decline-to-state voters of their ability to vote on a party ballot if allowed by the party.

- **Permanent Absent Voters.** Requires election officials to allow any voter to apply for permanent absent voter status.

- **Voter Identification Procedures.** Requires election officials to compare the signature on each provisional ballot with the signature on the voter's affidavit of registration using specified procedures.

- **Voter Registration Procedures.** Requires county clerks to accept affidavits of registration at any time up to 28 days immediately preceding the election.

The budget acts of 2015 and 2016 suspended the six election mandates. The date of suspension, along with the balance of amounts owed to local governments and the annual costs of funding the mandates, are shown in the table below. Note that if the mandates are "reactivated", the state must pay all past accrued costs, not just annual costs.

Election Mandates
Balance and Annual Costs
(Thousands of Dollars)

Mandate Title	Date Initially Suspended	Accrued Balance 2016	Estimated Annual Cost
Absentee Ballots	2011	$49,608	$24,800
Absentee Ballots – Precinct Tabulation	2011	68	34
Modified Primary Election	2013	1,817	316
Permanent Absent Voters	2013	11,907	4,700
Voter Identification Procedures	2013	10,075	1,600
Voter Registration Procedures	2011	2,481	1,300
Total Outstanding Balance and Annual Costs		**$75,956**	**$32,750**

The DOF report notes that data indicates a trend of voters moving away from traditional polling places and gravitating to a vote-by-mail system with a preference for permanent absentee voter status, and observes that state election laws have not adapted to these changing trends. With these considerations, and after discussions with stakeholders, the DOF report presents the following alternatives to funding the mandates:

- **Legislative Changes.** The report indicates that several of the mandates, together with existing election laws, result in redundancies, inhibit cost-effective election procedures, and may reduce the natural migration of voters to permanent absent voters. Specially, the report indicates that:

    - The Absentee Ballots mandate could potentially be repealed and voters encouraged to obtain permanent absent voter status. This would relieve local governments of significant ballot printing and polling place staffing costs.

    - Repealing the Absentee Ballots mandate could also render the need for the Absentee Ballots – Precinct Tabulation mandate moot. The non-reimbursable duty of local officials to maintain accurate voter lists would allow them to make needed precinct adjustments.

  - Repealing the Voter Identification Procedures mandate could reduce costs without compromising the intent of the legislation, since prior law already directs local election officials to "examine the records" associated with provisional ballots.

- **Voting Methods.** The report suggests a careful examination of the vote-centered method of voting, that would allow counties to send voters a ballot prior to Election Day, permit in-person voting before and through election day, and allow voting to occur at established centers for all voters, irrespective of the voters' county of residence. This approach would reduce dramatically the number of polling places and their associated costs.[1]

- **Competitive Grant Program.** The report recommends consideration of a competitive grant program (with a matching requirement), with a goal to develop innovative and outcome based processes at the local level to reduce election costs. Cost-saving activities could include system upgrades for processing, increasing uniformity implementing mandates, and development of best practices.

The DOF was also required to conduct a survey of county election officials regarding whether counties carried-out requirements set forth in the suspended mandates. Forty seven of the 58 counties responded with 40 of those returned surveys deemed complete. The survey indicated widespread compliance with the suspended mandate requirements. Specifically, all 40 respondents indicated complying with: Absentee Ballots – Precinct Tabulation; Modified Primary Election; Permanent Absent Voters; and, Voter Registration Procedures. All but two counties complied with both Absentee Ballots and Voter Identification Procedures.

Staff Comment. It is apparent that election laws have not evolved as quickly as election behavior, particularly with respect to absentee ballots, which now represent 60 percent of voters. While this trend suggests that the state should consider adjustments that align election laws with voter behavior, DOF acknowledges that additional research is needed. The survey conducted by DOF indicates wide-spread compliance among those counties whose responses were deemed complete. However, almost one-third of counties did not respond or responded incompletely. There is little reason to assume that counties that did not respond to the survey would display voluntary compliance with the requirements of the suspended mandates to similar degree as those counties which responded to the survey.

The DOF report provides a good starting point to address the significant budgetary impacts of election mandates, while being mindful of the sensitivity of the issues and the importance of election participation. Election law is a crucial policy area for the Legislature, and any changes in these laws should be based on extensive deliberation and analysis. While there is a significant budgetary impact in the decision to fund or not fund any election mandate, the policies surrounding such mandated activities should be considered in conjunction with the existing legislative policy-making procedures and protocols.

Staff Recommendation. Informational item.

[1] Colorado has implemented a vote-centered system and experienced substantial cost–savings. Data from the state indicates the cost of $16.00 per voter in 2008 was reduced to $9.56 per voter in 2012.

9210 LOCAL GOVERNMENT FINANCING
9100 TAX RELIEF

Item Overviews. Local Government Financing provides general-purpose revenue to counties, cities, and special districts when special circumstances occur. The program includes those payments to local governments where the funds may be used for any general government purpose as well as funds for one-time, designated purposes.

The Tax Relief item provides funding for cities and counties to help defray the loss of revenue as a result of the Homeowners' Property Tax Relief Program, the Open Space Subventions Program, and for 2017-18 provides for population-based incentive grants for cities and counties, to encourage their participation in the United States Census Bureau's update of its Master Address List for the 2020 Census.

Issue 1: Local Government Census Work (BCP)

Governor's Proposal. The Governor has proposed $7 million in grant authority to local governments that are to be used for participation in the Census Bureau's Local Update of Census Addresses (LUCA) program. The one-time program will be administered by the Department of Finance and will provide financial incentives for local governments to review and update the master address lists used to conduct the decennial census.

Background. Local governments are in a suitable position to provide information regarding housing, living quarters and other factors that can help inform the census undertaking. To provide assistance in this regard, the Legislature in 2007-08 appropriated $3 million for grants to local governments to assist in the census undertaking, with grant amounts ranging from $1,000 to $75,000. Possibly because of the potentially low grant amount, the participation rate among 535 counties and cities was only 42 percent, drawing down $1.8 million of the amount of funds available. The state also provided $2 million to the Complete Count Committee for the 2010 Census, which encouraged full participation in the census. (The Complete Count Committee also received $10 million in private funding.)

Under the proposed program, grants would range from $7,500 to $125,000, thus encouraging greater participation. Greater participation in the program for this census round is important, since the Census Bureau will no longer be conducting 100 percent canvassing, but rather rely on the US Postal Service, state and local governments, and third-party vendors to update the 2010 Census address list. The census results can have an impact on the calculation of federal funding; the undercount in 2000 cost the state an estimated $1.5 billion in federal funds over ten years for eight programs that rely on census data. The census is also used for congressional apportionment purposes.

Legislative Analyst's Office Comments. The Legislative Analyst's Office (LAO) suggests that the LUCA funds could be better targeted; in particular, county assessors could be better positioned, in some cases, to verify the Census Bureau addresses. County assessors are charged with maintaining the county rolls, which contain the addresses of all legal properties in the counties. Rather than distributing the funds across all cities and counties, encouraging LUCA participation by county assessors (on behalf of the county and its cities) could increase the funding available to each county. Targeting the work to the county assessors could result in a larger portion of California addresses being reviewed and verified.

Staff Comment: The proposal for increased resources to assure an accurate census count for the state is fiscally prudent, and will assure that California federal representation accurate reflects its population. It is not clear to staff how the exact figure of $7 million was arrived at and whether the amount reflects need, efficiency or simply an outside parameter. In addition, LAO raises a reasonable option regarding assessors. The department should consider language and program design that would incorporate the county assessors as an option, where appropriate.

Staff Recommendation: Hold open.

Vote.

Issue 2: Local Government Finance – Property Taxes and Vehicle License Fees (TBL)

Budget Issue. As a result of reductions in the vehicle license fee (VLF) and shifts of revenue sources pursuant to realignment (and previous legislation), some newly-incorporated cities – as well as cities with newly-annexed areas – do not receive revenue that they would otherwise have received under prior law. Specifically, cities used to receive additional VLF funding under the law prior to 2004. The reduction in financial resources has resulted in significant fiscal challenges for these cities, with potential impacts on their financial stability. The language before the subcommittee would increase the amount on a continuing basis of property taxes that are received by certain cities that incorporated after 2004 and before 2012. The change would reflect the following:

- For the 2017-18 fiscal year, the city's base VLF adjustment amount is calculated by multiplying the city's population by the per capita amount of countywide VLFAA funding received by cities in the county.

- For each fiscal year thereafter, the prior year's VL adjustment amount is recalibrated to reflect the year-to-year change in assessed property values within the city.

Background. In lieu of a property tax on motor vehicles, the state collects an annual VLF and allocates the revenues, to cities and counties. In 1998, the VLF rate was reduced from 2 percent to 0.65 percent of a vehicle's value and the lost VLF revenues to cities and counties were backfilled from the state's General Fund. Traditionally, VLF had been allocated on a per-capita basis, meaning new cities that incorporated, or existing cities that annexed inhabited areas, received larger shares of the VLF. As part of the 2004-05 budget agreement, the Legislature enacted the VLF-property tax swap, which replaced the VLF backfill from the state General Fund with property tax revenues (the VLF adjustment amount) that would otherwise have gone to schools through the Educational Revenue Augmentation Fund (ERAF). The state's General Fund backfilled schools for lost ERAF money to meet the Proposition 98 funding guarantee.

Prior to the VLF-property tax swap, a newly incorporated city received additional VLF revenues generally for the first seven years, based on a calculation of three times the number of registered voters in the city at the time of incorporation. However, the swap did not provide extra corresponding property tax revenues to cities yet to be incorporated. Therefore, cities incorporated after 2004 received less VLF funding than they would have if they had incorporated prior to the swap. AB 1602 (Laird) Chapter 556, Statutes of 2006, changed the allocation of VLF funds to restore the VLF revenues for city incorporations that were lost under the 2004 swap, based on a $50 per capita allocation, adjusted annually. SB 89 (Committee on Budget and Fiscal Review), Chapter 35, Statutes of 2011, implementing portions of the Governor’s public safety realignment proposal, reversed these provisions of AB 1602 and shifted the funds to state public safety programs that had been realigned to local governments. SB 89 redirected VLF revenues from newly incorporated cities to the Local Law Enforcement Account to help fund realignment.

SB 89 subtracted $15 million in the Motor Vehicle License Fee Account revenues in 2011-12 from four newly incorporated cities. By reducing the allocation of VLF funds to newly incorporated cities, the realignment shift had a significant impact on the fiscal viability of communities that rely on VLF revenues. Four new cities incorporated after AB 1602 enacted new VLF funding allocations for new cities and before those allocations were repealed, specifically: City of Wildomar, (incorporated July 1, 2008); City of Menifee, (incorporated October 1, 2008); City of Eastvale, (incorporated October 1, 2010), and City of Jurupa Valley, (incorporated July 1, 2011).

SB 107 (Senate Committee on Budget and Fiscal Review), Chapter 325, Statutes of 2015, included a mechanism to provide nearly $24 million in fiscal relief to the four recently incorporated cities that lost funding under SB 89’s reallocation of VLF revenues. The fiscal relief authorized by SB 107 was used to forgive more than $1 million in debts owed by the cities of Wildomar and Menifee and more than $21 million in debts owed by the City of Jurupa Valley for services the County of Riverside provided to those cities after they incorporated. The one-time fiscal relief provided by SB 107 did not address the ongoing fiscal impact of SB 89 on these cities.

Staff Comment. Cities argue that SB 89's elimination of VLF allocations jeopardizes the financial viability of recently incorporated cities and cities that annexed inhabited areas. Local officials want the Legislature to recalculate the VLF adjustment amount to give additional resources to four recently incorporated cities and to cities that annexed inhabited areas after 2004. SB 89 effectively returned VLF funding for city incorporations to the amounts that were provided for in the original 2004 VLF-property tax swap. The higher VLF adjustment amounts they would receive under the formula in the trailer bill language would reduce the amounts of property tax revenues they contribute to ERAF. This would typically result in increased General Fund pressure, to the extent the state must backfill the property tax revenues that schools won't get from ERAF. The annual loss to the state General Fund would increase in the future.

Staff Recommendation: The subcommittee should consider adoption of the trailer bill language.

Vote: