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, May 18, 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 VOTE-ONLY

ITEMS FOR DISCUSSION AND VOTE

Public Comment

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ISSUES PROPOSED FOR VOTE-ONLY

C.S. 12.00 STATE APPROPRIATIONS LIMIT

Issue 1: Revised State Appropriations Limit (May Revision)

Governor's Proposal. The Administration requests that the budget bill be amended to reflect the updated change in the State Appropriations Limit (SAL). The revised limit of $103.4 billion is the result of applying the growth factor of 4.22 percent. The revised 2017-18 limit is $399 million above the $103.0 billion estimate in January.

Staff Comment: Staff has no concerns with this technical change.

Staff Recommendation: Approve the revised State Appropriations Limit.

Vote:

0110/0120 STATE LEGISLATURE

Issue 1: Constitutional Adjustment (May Revision)

Governor's Proposal. The Legislature's budget for 2017-18 was proposed in January to be $128.8 million for the Senate and $169.7 million for the Assembly. Under the terms of Proposition 140, the growth in the Legislature's budget is constitutionally limited to the growth in the state's appropriation limit (SAL). The year-to-year SAL increase is calculated to be 4.22 percent in the Governor's May Revision. Applying this to the legislative budget would result in funding of $134.2 million for the Senate and $176.8 million for the Assembly.

Staff Comment. The Senate's budget was held constant from 2008-09 to 2009-10, reduced by a negative SAL of -1.77 percent in 2010-11, received no increase in the subsequent two years (2011-12 and 2012-13), then received increases of 5.8 percent in 2013-14, 0.48 percent in 2014-15, 4.55 in 2015-16 and 5.96 in 2016-17. Senate increases were forgone because of the state's budget constraints during the previous recession. The combined spending by the Senate and the Assembly is still well below the State Appropriations Limit. Funds from the Senate and Assembly appropriations are also used to fund the Legislative Analyst's Office in the amount of $9.1 million.

Staff Recommendation. Staff recommends that the Legislature's (Senate and Assembly) budget be adjusted as provided in the State Constitution, resulting in a total increase for the Legislature of $12.6 million, and that the Legislative Analyst's Office receive its SAL-adjusted share of $9.1 million from the Senate and the Assembly.

Vote:

9100 TAX RELIEF

Issue 1: Staffing for Local Government Census Work (BBL)

Governor's Proposal. The Governor 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 funding was approved at the Subcommittee No. 4's hearing on May 11, 2017. In the May Revision, the Administration has proposed budget bill language to specify that the funding may be used for hiring a census outreach coordinator as well as for local grants. The additional budget bill language states:

> *These funds shall be available for encumbrance or expenditure until June 30, 2020. Additionally, the amount appropriated in Schedule (3) may also be used by the Department of Finance for costs related to the hiring of a Census Outreach Coordinator for the 2017-18 through 2019-20 Fiscal Years.*

Background. 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.

Staff Comment: Staff has no concerns with the language.

Staff Recommendation: Approve budget bill language.

Vote:

0840 STATE CONTROLLER'S OFFICE

Issue 1: Personnel Reclassification Costs (May Revision)

Governor's Proposal. The May Revision includes a request from the State Controller's Office (SCO) for $600,000 ($342,000 General Fund) for costs associated with reclassifying 38 accounting administrator positions to financial accountants. The funding is for two years, after which increased costs will be absorbed by efficiencies associated with lower turnover and more highly specialized personnel.

Background. The financial accountant series was established by the Department of Human Resources (CalHR) in 2015. The SCO petitioned CalHR for authority to use this series in 2016, which was approved.

Staff Comment. Staff has no concerns with the proposal.

Staff Recommendation. Approve the May Revision Request.

Vote:

Issue 2: Unclaimed Property Securities Accounting (BCP)

Governor's Proposal. The State Controller's Office (SCO) requests $2.9 million (Unclaimed Property Fund) in 2017-18, and ongoing, and 23.1 permanent (continuing) positions to manage and maintain the security portfolio, pay security claims, and sell securities within the allotted timeframe. The resources will be used for managing the stock and mutual fund corporate action workload; ensure compliance with the UPL by selling securities in a timely fashion; reconcile and post dividends, interest, proceeds and any other income; process security claims in a timely manner to reduce litigation; manage and maintain the securities portfolio; and, reconcile the portfolio and integrate internal controls. Most of the positions will be assigned to securities issue analysis, reconciliation, and research and property recordation. The remaining positions are for accounting and support activities.

Background. The California UPL was enacted to assure that property is returned to its rightful owners or their heirs. This law gives the state an opportunity to return the property and provides California citizens with a single source, the SCO, to check for unclaimed property that may be reported by holders from around the nation. By law, holders of unclaimed property (such as banks) must report and remit unclaimed property to the SCO after a specified period of time.

Under the program, holders are required to proceed through a series of steps before remitting property to the SCO. A holder notice report submitted by the holder is used by the SCO to send out pre-escheat notices to rightful owners or their heirs, advising owners to contact holders directly to retrieve the reported property, giving the owners the opportunity to reestablish contact with the holders, or have their property sent directly to them. After filing a holder notice report, holders are required to provide the SCO with a holder remit report containing the information on any remaining properties that were not reclaimed by the rightful owners or their heirs. At the time the holder remit report is filed, holders are required to remit the property to the SCO.

The current proposal converts the temporary positions continued in the 2014-15 budget into permanent ones, with a focus on working down the existing backlog of property, addressing current workload, and providing managerial oversight. The division also received an augmentation in 2016-17 for the purposes of streamlining procedures, increasing outreach and detecting and preventing fraud.

Legislative Analyst's Office Comment. This issue was heard in Subcommittee No. 4 on March 23rd. The LAO notes that without a change in the program, additional workload will continue and require additional funds. LAO indicates that the workload of managing securities prior to sale is substantial, and notes that the process could be accelerated (reducing the workload) if state law were changed to allow property to be sold and converted to cash more quickly. Currently, the SCO must wait at least 18 months after receiving the report from the holder before converting any property into cash.

Staff Comment. The continued commitment of resources makes sense given the continued level of activity associated with unclaimed property. The vacancy rate of 23 percent is somewhat high, and could be reduced by converting the limited-term positions (where most of the vacancies are) to permanent. However, the division has expanded rapidly over the last few years, from 15.1 authorized positions in 2011-12 to 35.5 positions in 2015-16 (mostly limited-term). This has resulted in security sales proceeds increasing from $64.6 million to $85.9 million, but other portfolio measures have expanded significantly as well, indicating an increasing workload. Staff views the 18 month waiting period before selling securities is a reasonable policy, given the gravity of the escheat process.

Nevertheless, LAO comments regarding increasing workload are well-founded and the department should explore other means of achieving efficiencies. The department should prepare options for legislative consideration in anticipation of the 2018-19 budget, and provide a supplemental report in this regard by December 1, 2017.

Staff Recommendation: Approve as budgeted and supplemental report language.

Vote:

0950 STATE TREASURER'S OFFICE

Issue 1: Debt Management System Funding Reallocation (May Revision)

Governor's Proposal. The May Revision includes a request from the State Treasurer's Office to reallocate funding for its Debt Management System II among fiscal years, with no change in overall funding levels. The change would shift to 2017-18, project costs of $42,000 from 2016-17 and $300,000 from 2018-19. There is no General Fund impact from the proposal.

Background. The STO's Debt Management System is an upgrade to its existing debt tracking system, and is funded through bond funds.

Staff Comment. Staff has no concerns with the proposal.

Staff Recommendation. Approve the May Revision Request.

Vote:

0860 BOARD OF EQUALIZATION

Board of Equalization Vacancy Redirection. The Governor's budget includes five BCPs requesting $43.4 million and 134.6 positions in fiscal year 2017-18 for the Board of Equalization (BOE). The 134.6 positions consist of a continuation of 19 limited-term positions, 71.6 new positions, and 44 temporary help positions. These resources were a response to recently enacted legislation, voter referendums, and BOE's ongoing information technology project.

In recognition of its significant vacancy rate, BOE worked with the Department of Finance to identify Governor's budget positions that can be absorbed by utilizing existing vacancies. As a result of this effort BOE proposes a revised request of $33.6 million and 64.8 positions. The 64.8 positions consist of a continuation of 19 limited-term positions, 1.8 new positions, and 44 temporary help positions. This represents a reduction of $9.5 million and 67.9 positions from the 2017-18 Governor's budget request.

BOE will redirect 67.9 vacant positions and delete two positions from the original request. The net result will only require the addition of 1.8 new positions. These redirections will result in corresponding reductions in operating expenses. In developing this proposal, BOE considered positions for redirection utilizing the April 2017 vacancy report that were: 1) left vacant for more than seven months; 2) were not in active recruitment; 3) were not held open due to a leave of absence. Effort was made to towards avoiding the redirection of vacant revenue-generating positions towards filling non-revenue generating BCP positions. The revised proposal will allow the BOE to fulfill its statutory duties while also reducing its vacancy rate. The Department of Finance has reviewed the BOE's request and is in agreement with the proposed changes.

Issue 1: Centralized Revenue Opportunity System (BCP)

Governor's Proposal. The budget includes a proposal from BOE to provide funding for its continued work on the Centralized Revenue Opportunity System (CROS). For 2017-18, the request is for $30 million ($17.2 million General Fund) and 65.4 positions. The five year request increases to $50.9 million in 2018-19, $66.6 million in 2019-20, and dropping to $17.1 million in 2020-21 and $19.2 million in 2021-22. Of the request, about one-half of the cost is for personnel – largely technology and tax professionals – and one-quarter of the cost is for professional consulting services. Resources would be distributed in the following areas: business management, contract management, organizational change management, technical management, and project management.

Revised Request. The revised proposal for the CROS request constitutes $28.6 million and 55.4 positions (19.0 limited term positions and 36.4 temporary help) and a redirection of $1.2 million and 10.0 vacant positions. The revised five year request increases to $49.6 million in 2018-19, $65.3 million in 2019-20, and dropping to $15.8 million in 2020-21 and $17.9 million in 2021-22.

Background. BOE is in the process of consolidating and modernizing its existing taxpayer information systems through the CROS project. As designed, CROS would replace the BOE's two existing systems of tax information and return management, expand online business and taxpayer services, and provide an agency-wide data warehouse. CROS would replace two legacy systems, the Integrated Revenue Information System (IRIS) and the Automated Compliance Management System (ACMS).

The Feasibility Study Report (FSR) approved September 2011, redirected BOE resources to the CROS project in order to proceed with the procurement phase. Special Project Report 1 (SPR 1) was submit on March 2012, and based on this, staffing was authorized, as well as funding for audit, collection and registration backlogs. SPR 2 was submitted in December 2013, addressing a nine month change in the procurement schedule and extending the implementation by one year. The CROS project subsequently submitted SPR 3, which called for an additional delay of 19 months in the procurement phase. Based on SPR 3, BOE submitted a May Revision request in 2016 to begin its implementation phase. The request asked for five years of funding; the Legislature chose to fund the first year only. BOE approved the selection of the CROS contractor (Fast Enterprises) and the CROS solution (GenTax) in August 2016. SPR 4 was submitted in October 2016, which included a resource analysis, project deliverables, project schedule, project management plans and technical capabilities.

The acquisition of CROS will be achieved through a performance-based, benefits-funded procurement approach. This approach is similar to that used by the Franchise Tax Board (FTB) and the Employment Development Department (EDD) for their respective information and data management systems. The approach does not require up-front vendor funding, as the development and implementation costs are paid under a benefits-funded contract, with payment allowed only when increased revenues are received. Contractor payments would be dependent on the generation of additional revenues attributable to the project and would be capped overall.

Staff Comments. The CROS project is a necessary undertaking for the state, given the age and status of the agency's legacy mainframe-based revenue and collection information systems. The budget proposal for continued funding of the CROS project is reasonable with respect to anticipated workload during the implementation phase. In addition, the benefits-based funding for the project is appropriate for the tax agency; a similar approach has been used successfully by the FTB. Nevertheless, as noted last year, staff has significant concerns regarding the ability of the agency to successfully undertake a project of this importance and magnitude. The governance of large and complex undertakings, like the CROS project, is a challenge for the best-managed organizations, and even more so for agencies with management issues, like the BOE. Clearly, the BOE, in most cases, functions adequately, but instances of questionable management and decision-making nevertheless raise concerns.

Previous information technology projects that have failed to meet expectations have generally fallen short, not because of technical challenges, but due to the failure of adequate oversight, management and governance. The state experienced the failure and termination of the 21st Century Project, in which the state invested approximately $300 million dollars, and it is likely that the state will realize little by way of useful product from this investment. On the other hand, more positive examples are also available. FTB devoted much deliberation, effort and resources to working through project management and oversight issues related to its Enterprise Data to Revenue (EDR) project. Although this project was not without some uncertainties and delays, the structure of responsibility was such that the agency was able to adjust to these contretemps while keeping the overall project on track. Similarly, the Financial Information System for California (FI$Cal) project has devoted considerable discussion to the governance and management issues in order to maintain the integrity of the final product.

Project governance models and management structures are crucial, not because of routine decisions or quotidian activities, but rather for instances of technical challenge and impediments to implementation. Staff notes that IT projects, by their very nature, carry with them inherent unknowns both in design and timeline. Nevertheless, the CROS history to date is not at all encouraging – the FSR was approved five years ago, in 2011; SPR 1, outlining two strategies for procurement, was submitted in March 2012; SPR 2 was then submitted in December 2013, addressing a nine month change in the procurement schedule and one year delay in implementation; and, SPR 3 was submitted in April 2016 to address an additional 19 month delay in the procurement phase. Meanwhile, the CROS project itself has experienced some leadership issues. The agency is currently recruiting for a new project director.

Budget Bill Language. The Administration has requested that the proposed budget bill language governing the CROS project be revised as follows:

> *The Department of Finance may augment the following items in the 2018–19 fiscal year by the amount of any unencumbered funds for vendor compensation payments related to the Centralized Revenue Opportunity System as of June 30, 2017, in those items: 0860-001-0004, 0860-001-0022, <u>0860-001-0061,</u> 0860-001-0070, 0860-001-0080, 0860-001-0230, 0860-001-0320, 0860-001-0387, 0860-001-0439, 0860-001-0465, 0860-001-0623, 0860-001-0965, 0860-001-3015, 0860-001-3058, 0860-001-3063, 0860-001-3065, 0860-001-3067, 0860-001-3212, 0860-001-3251, 0860-001-3260, 0860-001-3270, <u>0860-001-3288</u>,and 0860-001-3301, <u>0860-001-3304, and 0860-001-3308</u>. Any*

augmentation pursuant to this provision shall be reported in writing to the Joint Legislative Budget Committee within 30 days.

Staff Recommendation. Reject Governor's January proposal. Approve revised request for 2017-18 only, and adopt proposed budget bill language.

Vote:

Issue 2: Cigarette and Tobacco Products Licensing Program (BCP)

Governor's Proposal. The budget calls for $286,000 (special funds) in 2017-18, and approximately $200,000 in 2018-19 and ongoing, to administer recent legislation regarding the Cigarette and Tobacco Products Licensing program. The legislative changes call for annual rather than one-time, license renewal fees, and expand the definition of tobacco products to include nicotine products and vaping devices and accessories. The additional resources will address ongoing overtime in the areas of: outreach, registration, account renewal, payment processing, refunds and account close-outs, enforcement, and administrative support. The agency indicates that it will use existing resources to address additional costs imposed in the current year. There were no post-submission changes to this proposal.

Background. In 2003, the Legislature enacted statutes establishing the Cigarette and Tobacco Products Licensing Act which established a statewide licensing program administered by the BOE to address untaxed sales and illegal distribution of these products. The act requires the BOE to administer a statewide program to license cigarette and tobacco products manufacturers, importers, distributors, wholesalers and retailers. The most recent legislation increases the per-location fee from $100 to $265, changes the fee basis from one-time to annual, and expands tobacco products to encompass a wide range of products containing, made or derived from tobacco or nicotine, as well as nicotine delivery systems.

Staff Comments. This proposal was heard at the Subcommittee No. 4 hearing on May 4th. Based on information provided, staff has no further concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote:

Issue 3: Lead-Acid Battery Fee (BCP)

Governor's Proposal. The budget calls for $1.2 million and 3.1 positions in 2016-17, $837,000 and 6.3 positions in 2017-18, $1.4 million and 8.6 positions in 2018-19, and $1.4 million and 10 positions in 2019-20 and ongoing (all special funds) to implement and administer the Lead-Acid Battery Recycling Act (LABRA) of 2016. The program implementation will be paid from a loan to the Lead-Acid Battery Clean-Up Fund from the California Tire Recycling Management Fee. Ongoing costs of the program will be paid by the new fee imposed by the LABRA. Imposing the new program and its ongoing administration requires additional activities related to registration, return process, collections, audits, appeals, refunds, allocation and other administrative functions.

Revised Request. The revised proposal for the Lead-Acid Battery Program consists of $233,000 and 1.8 positions and redirection of $541,000 and 4.5 vacant positions. The revised five year request is for $921,000 in 2018-19, $952,000 in 2019-20, $950,000 in 2020-21 and $950,000 in 2021-22.

Background. The LABRA imposes a new fee of $1 on each battery until March 31, 2022, and $2 per battery beginning April 1, 2022, on consumers and manufacturers of lead-acid batteries. Revenues collected, less refunds and expenses reimbursement to the BOE, will be deposited in the Lead-Acid Battery Clean-Up Fund and used for clean-up costs associated with the batteries. Ongoing costs of the program are paid from the fee, which is collected from retail dealers. The dealer is allowed to retain 1.5 percent of the fee collected to meet their own collection costs. The new fee program will add an addition 20,000 fee-payers to BOE's existing base.

Staff Recommendation. Reject Governor's January proposal. Approve revised request based on BOE and DOF recalibration.

Vote:

Issue 4: California Tobacco Tax Act Implementation– Proposition 56 (BCP)

Governor's Proposal. The budget calls for $6.9 million and 40.9 positions in 2017-18, $5.6 million and 37.4 positions in 2018-19, $5.3 million and 34.6 position in 2019-20, and $910,000 and 4.9 positions in 2020-21 and ongoing (all special funds), to implement and administer the California Healthcare, Research and Prevention Tobacco Tax Act (CHRP) approved in November 2016. The measure increased the tax on cigarettes by $2 per pack, indirectly imposed an equivalent tax on other tobacco products, imposed a one-time floor stock tax, and expanded the definition of tobacco products to include e-cigarettes and nicotine products and related delivery products. The positions include auditors, tax technicians, business tax specialists and representatives, attorneys, and compliance specialists.

Revised Request. The revised proposal for this issue consists of $2.0 million and 3.7 positions, and redirection of $4.2 million and 37.3 vacant positions. The revised five year request is for $1.8 million in 2018-19, $1.8 million in 2019-20, $102,000 in 2020-21 and $102,000 in 2021-22.

Background. California imposes excise taxes on cigarettes and on other tobacco products, such as cigars and chewing tobacco. The state also licenses sellers, distributors, and manufacturers of these products, and BOE administers these tax and licensing programs. In 2016, the Legislature made significant changes to the tobacco licensing program, by expanding the licensing program to include electronic cigarettes (also known as e-cigarettes) raising license fees, and replacing the one-time fee for retailers with an annual fee.

In November 2016, California voters passed Proposition 56, effective April 1, 2017, increasing the state excise tax rate on cigarettes by $2 per pack (from 87 cents to $2.87), which indirectly increased the state excise tax on other tobacco products by a similar amount. The measure established a new special fund for the resulting tax revenue, and it laid out a variety of spending requirements, including a couple of provisions setting aside resources for BOE. Proposition 56 also expanded the tax base for the excise tax on other tobacco products to include e-cigarettes.

Legislative Analyst's Office Comments. The Legislative Analyst's Office (LAO) indicates that the workload assumptions are reasonable. Proposition 56 contains two provisions that allocate funding to BOE – a broad allowance for administrative costs and $6 million per year to enforce certain types of tobacco laws. BOE's proposal includes $5.8 million in 2017-18, $5.0 million in 2018-19, $4.8 million in 2019-20, and $0.7 million in 2020-21 and ongoing, for enforcement of tobacco laws. These resources would be used for investigations, appeals, collections, and audits related to tobacco taxes, and would come from the new tobacco taxes.

The LAO notes the Administration's request of $5.8 million for enforcement in 2017-18 is less than the amount required by Proposition 56. This amount is one piece of a larger sum that, according to the measure, "annually shall be used for the purpose of funding law enforcement efforts." Within the law enforcement category, the measure states that a specific amount "shall be apportioned" to BOE. The Administration interprets "annually shall be used" and "shall be apportioned" to include not only current spending, but also money set aside for future spending. However, the Administration has not established a sub-account specifically for BOE, so revenue set aside for future BOE spending is not apparent. In addition, the vast majority of this money is limited-term.

Proposition 56 requires that a certain sum of money "annually shall be used for the purpose of funding law enforcement efforts" and that $7.5 million "shall be apportioned" to BOE in 2017-18 ($6 million per year thereafter). LAO interprets this requirement to mean that $7.5 million – a larger amount than the Administration has requested – must be appropriated for this purpose in 2017-18. LAO recommends permanent funding of these enforcement activities and limited-term authority for other administrative positions.

Staff Comment. BOE has taken a reasonable approach to estimating the tobacco licensing and tax administration workloads for these proposals. Nevertheless, there are substantial uncertainties regarding the impact of the measure, including the amount of tax evasion given the significant increase in the tax, the lack of data regarding the e-cigarette industry and the likely number of registrants. LAO also notes that the workload estimates assume no reduction in the taxpayer or licensee population due to the new taxes imposed by Proposition 56 and indicates that some decline would be reasonable response.

Staff Recommendation. Reject Governor's January proposal. Approve revised request based on BOE and DOF recalibration.

Vote:

Issue 5: County of Los Angeles Measure H - Homelessness (TBL)

Proposal. According to the proponents, the proposed language would clarify that a local sales tax measure adopted by the County of Los Angeles can be collected in jurisdictions that have reached their two percent cap on local sales taxes. The county-wide measure (Measure H) was drafted to comply with the two percent statutory limit on local sales taxes, by taking into account the seven cities within the County which have reached the two percent cap. Under Measure H, transactions in those cities which have reached the two percent sales tax cap are not subject to the ¼ percent additional sales tax. The BOE has requested that the County obtain statutory clarification to implement Measure H.

Background. The County of Los Angeles, in 2015, developed strategies to reduce homelessness. In February 2016, the Board of Supervisors approved a set of strategies that were designed to: prevent homelessness, subsidize housing, increase income, provide case management and services, create a coordinated system, and increase affordable/homeless housing. The board allocated $100 million in one-time funding to support the initial implementation of the approved strategies, while expressing its intent to pursue an ongoing revenue source to sustain and expand the strategies. In December 2016, the board placed Measure H, a 10-year special ¼ percent sales tax to prevent and combat homelessness, on the March 7, 2017 countywide ballot, which was approved by approximately 70 percent of the voters.

Measure H is estimated to generate $355 million annually and enable 45,000 homeless families and individuals to move from homelessness into permanent housing in the next five years, while enabling an additional 30,000 families and individuals to avoid becoming homeless. Measure H will primarily fund outreach, interim housing, rental subsidies, and supportive services, and will leverage efforts to increase the supply of permanent supportive housing, including the State of California's No Place Like Home initiative and other local measures.

Staff Comment. Staff is not aware than this particular method of exempting jurisdictions (which participated in the election that authorized Measure H) from the tax if its collection would result in exceeding the two percent cap has ever been previously enacted. In cases where the imposition of a tax would result in exceeding the cap, local jurisdictions generally submit a request to the Legislature for statutory authority to increase the cap headroom. Nevertheless, the proposed language submitted provides the clarification needed by the BOE, and is specific to Measure H, with no impact on any other sales tax which any city or county has enacted or may seek to enact in the future. This measure was heard in Subcommittee No. 4 and held open; since that hearing additional clarifying provisions have been added.

Staff Recommendation. Adopt placeholder trailer bill language.

Vote:

1701 DEPARTMENT OF BUSINESS OVERSIGHT

Issue 1: Broker-Dealer and Investment Advisor Program (May Revision)

Governor's Proposal. At its March 23rd hearing, the Subcommittee approved the Governor's proposal to add $1.7 million (special funds) and 11 permanent positions to expand the examination cycle as part of the Department of Business Oversight's (DBO's) enforcement and regulatory responsibilities. This additional proposal would approve supplementary reporting language requiring the DBO to report on efficiencies and effectiveness of the program. The proposed SRL is:

> *The Department of Business Oversight shall provide a report on the Broker-Dealer Investment Advisor (BDIA) Program to the Department of Finance, Legislative Analyst's Office, and the relevant budget subcommittees of both houses of the Legislature on January 10 with the release of the Governor's Budget each year. In addition to the information required by the budget bill, this report shall include the following information: (1) identification of potential options for increasing the efficiency and cost-effectiveness of oversight over BDIA licensees. These options shall include, but not be limited to (a) enhanced coordination with other entities providing oversight of BDIA licensees such as the Financial Industry Regulatory Authority and the U.S. Securities and Exchange Commission, (b) options for lengths of examination cycles for various groups of BDIA licenses, and (c) options for prioritizing the examination of higher risk BDIA licensees; (2) a description of any efforts to date to explore these options and any resulting findings or conclusions; and (3) any resulting recommendations regarding how to increase the efficiency and cost-effectiveness of oversight over BDIA licensees.*

Staff Comment. Staff has no concerns with the proposal.

Staff Recommendation. Approve proposed supplemental reporting language.

Vote:

ISSUES PROPOSED FOR DISCUSSION AND VOTE

C.S 1.80 AVAILABILITY FOR APPROPRIATION

Issue 1: Clarify Encumbrance and Expenditure (May Revision)

Governor's Proposal: The May Revision includes a request for budget bill language and trailer bill language that would clarify the ability of department's to expend and encumber funds. The budget bill language would change Control Section 1.80 such that appropriations would be deemed available for encumbrance as well as direct spending without such encumbrance in advance. Similarly, the proposed trailer bill language would make it clear that encumbrances can be initially estimated and then adjusted during the liquidation period when costs become apparent. The language also addresses the reversion of unencumbered balances.

Staff Comment. Staff has no concerns with the proposed language.

Staff Recommendation. Adopt proposed budget bill language and trailer bill language.

Vote:

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Issue 1: California Small Business Development Center Program (May Revision)

Governor's Proposal: The Governor's Office of Business and Economic Development (GO-Biz) has requested one time appropriation of $2 million (General Fund) as a partial match of federal funds to support the Small Business Development Center (SBDC) network.

Background: The SBDC provides training to small business owners, including in the areas of start-up assistance, planning for growth and expansion, technology and innovation, and access to capital. The funds will be used for competitive grants to the 44 SBDC offices, and require quarterly reports on results. After receiving no funding from the General Fund from 2004 through 2010, the SBDC program received a one-time $6.0 million in 2011 and then $2.0 million in General Fund in 2014 and 2015 and $1.5 million in 2016. No General Fund was received in 2012 or 2013.

The federal Small Business Administration (SBA) provides up to $13.9 million of federal grant funds to California SBDC network, distributed among six regions, if the state can meet the required one-to-one match. Absent this match, any available funds are reallocated to other states. Of the required match, 50 percent of the match can be in-kind match and the other 50 percent must be in the form of a local cash match. Go-Biz administers the SBDC grant, which is designed to assist in providing some of the local cash match needed by local organizations. Although the SBDC competitive grant does not fulfill the entire cash match requirement, the SBDC activities related to the grant are designed to attract additional cash match to the SBDC network.

Staff Comments: The proposal will help with SBDC funding, but there should be additional efforts to stabilize support for the program, especially given the erratic nature of state support. In addition, the proposal will only allow for a partial draw on available federal funds, unless additional resources can be accessed. Funding of $1.5 million was provided in the current year. The subcommittee may want to determine how successful the program has been in accessing other funds, as well as in-kind contributions, in order to maximize available federal funds.

Staff Recommendation: Approve the May Revision request.

Vote:

0984 CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

Issue 1: California Secure Choice Retirement Savings Program Implementation (BCP, BBL and TBL)

Governor's Proposal. The California Secure Choice Retirement Savings Investment Board requests a General Fund loan of $170 million over four years to provide resources for the board and the California Secure Choice Retire Savings Investment Program (CSCRSP), including: funding for staff; funding for external consultants; funding necessary for operating and overhead costs; and, funding necessary to execute agreements with third party administrators to provide record-keeping, investment management and other necessary services to route, receive and invest contributions from program participants. The proposal includes budget bill language (BBL) that would allow for the transfer of $15 million of the loan to the board in the budget year, with additional loan augmentations not to exceed $35 million upon approval by Department of Finance. In addition, trailer bill language is proposed clarifying the implementation of the program with respect to federal requirements

Background. The California Secure Choice Retirement Savings Investment Board and the CSCRSP were established pursuant to SB 1234 (de León), Chapter 734, Statutes of 2012, for the purpose of creating a statewide savings plan for private-sector workers who lack access to an employer-sponsored retirement savings plan. Program costs and revenue will be determined by the number of employers and employees participating in the program, contributions made by participant, and the investment return on those contributions. The General Fund loan will allow the board to administer the CSCRSP under conservative baseline assumptions relating to participation and contributions during the initial years. This proposal was discussed in Subcommittee No. 4 at its March 2 hearing and held open. The proposed budget bill language states:

> *The Department of Finance may transfer up to $15,000,000 as a loan from the General Fund to support the start-up and administrative costs of the Secure Choice Retirement Savings Program. This loan shall be repaid by June 30, 2023, with interest calculated at the rate earned by the Pooled Money Investment Account at the time of the transfer. Notwithstanding any other provision of law, the Department of Finance may augment the loan, for a total loan amount of ~~$50,000,000,~~ $35,000,000 if it is determined that additional funds are necessary for the start-up and administrative costs of the Secure Choice Retirement Savings Program. The loan shall be repaid by June 30, 2023, with interest calculated at the rate earned by the Pooled Money Investment Account at the time of the transfer.*

Staff Comments. As the CSCRSP begins the process of implementation, the necessity of startup funding to make this possible is apparent. Subsequent to the March 2 hearing, the agency and DOF indicated the acceptability of a General Fund loan for the budget year in the amount of $15 million, with budget bill language that allows this to be supplemented by $35 million upon DOF approval.

Staff Recommendation. Approve limited General Fund loan for the budget year, along with budget bill language and placeholder trailer bill language.

Vote:

7730 FRANCHISE TAX BOARD

Issue 1: Voluntary Personal Income Tax Check-Offs (TBL)

Legislative Proposal. This proposal would reduce to zero for the 2016 taxable year, the minimum contribution requirement for voluntary contribution to funds that appear on the personal income tax return. The minimum contribution requirement is the amount that must be contributed to the fund in order for it to remain on the tax return in the subsequent year.

Background. Tax check-offs are listed on the personal income tax return, and provide an opportunity for tax filers to contribute to various organization when filing their taxes. Some voluntary contribution funds are required to meet a minimum contribution test. If a voluntary contribution fund does not receive the required dollar amount of contributions the fund is repealed and removed from the tax returns the following year. For example, if a fund did not meet the minimum contribution threshold in 2016, the fund would be removed from the 2016 tax return, which is filed in 2017. For the current filing season, FTB has seen a sharp decline in the amounts contributed to the Voluntary Contribution Funds included on this year’s income tax return. For the period of January through March 2017, it received a total of $1 million compared to $2.3 million last year, and has determined that the decline is due to a change in the tax preparation experience in Intuit’s TurboTax product. FTB has contacted Intuit and they are responsive to making changes to their software for the 2016 return and reevaluate the product for the 2017 return. This issue causes two concerns: 1) the majority of funds will not meet their minimum contributions to remain on the tax return for the 2017 tax year, and 2) Some funds may experience ongoing concerns due to lack of tax return contributions.

Staff Comment. Staff has no concerns with the proposed language.

Staff Recommendation. Adopt proposed trailer bill language.

Vote:

0860 Board of Equalization

Issue 1: Board Member Budgets (BBL and TBL)

Administration Proposal. The Administration proposes to establish a new item within the Board of Equalization (BOE) line item authority for each of the four board members. This represents the Administration's follow-up to the recent evaluation of the BOE by the Department of Finance, Office State of Audits and Evaluations (OSAE). The proposal includes budget bill language and placeholder trailer bill language that would be consistent with this budgetary reorganization and other BOE-related issues.

Background. The OSAE evaluation found significant lapses in management and operations at the agency, including board member involvement in daily activities, violations of state law regarding the use of resources, and inadequate documentation and data evaluation.

Staff Comment. The proposed split of board member budgets from the BOE's administrative functions and activities should add clarity to the use of resources within the agency.

Staff Recommendation. Adopt budget item for board members, budget bill language and associated placeholder trailer bill language for BOE-related issues.

Vote:

Issue 2: Taxation of Vested Property (TBL)

Legislative Proposal. The proposal would exclude from the sales and use tax the transfer of vested property by a pawnbroker to a person who pledged the property to the pawnbroker as security for a loan, under certain conditions. The transfer is to occur no more than six months after the property is vested with the pawnbroker and the person has proof that sales tax was originally paid on the item.

Background. Under current law, if a customer defaults on a pawnbroker loan, the collateral becomes pawnbroker property. After title has vested with the pawnbroker, the customer no longer has any legal right to the property that would distinguish him or her from any pother customer. Thus when the customer subsequently seeks to purchase the collateral, the transaction counts as a taxable retail sale and the sales and use tax applies.

Staff Recommendation. The subcommittee should consider the proposal described above.

Vote:

8880 DEPARTMENT OF FINANCIAL INFORMATION SYSTEM FOR CALIFORNIA

Issue 1: Support for Equipment Purchases (May Revision)

Governor's Proposal. The Governor has proposed budget bill language that would allow for an increase in Department of Financial Information System for California (FI$Cal) for unanticipated customer service costs and equipment purchases. The augmentation of up to would occur upon approval of the Department of Finance (DOF) and notification of the Joint Legislative Budget Committee.

Legislative Analyst's Office Comments. The Legislative Analyst's Office (LAO) questions the need for broad flexibility in the provisional language. LAO identified several questions for legislative consideration, as noted below:

- What is the concern or issue the Administration is attempting to address through this proposal?
- Should the language be more specific regarding the circumstances of its use?
- What is meant by "unanticipated" costs – relative to what?
- Should a monetary cap be added to the language?
- How should this language interact with Control Section 11.00?
- Should the Legislature have an opportunity to review the request prior to the approval of the augmentation?

Staff Comment. Staff is concerned about the open-ended nature of the language and does not recommend approving as proposed. Staff is working with FI$Cal and the DOF to place additional parameters around the magnitude and purpose of any augmentation.

Staff Recommendation. Hold open.

Vote:

9210 LOCAL GOVERNMENT FINANCING

Issue 1: Community Transitional Housing Program (TBL)

Governor's Proposal. The Governor's proposes to add new trailer bill language to the statutory authority regarding the Community Transitional Housing Program (CTHP) that was adopted last year. The proposed language broadens the ability of cities and counties to use program funds including supporting the provision of services to facility residents, or for any other purposes that the governing board determines will enhance outcomes for facility residents or public safety in and around the facility.

Background. The CTHP was created as part of the 2016 Budget Act, and is funded at $25 million, and is administered by the Department of Finance. The program allows cities and counties to apply for grants of up to $2 million so they may partner with a facility operator to provide transitional housing and educational, behavioral, and rehabilitative services to persons released from incarceration, or to any other persons who may benefit. The city or county must provide a conditional use permit or equivalent entitlement that allows the facility to operate for at least 10 years. The city or county receives 60 percent of the grant funds and the facility operator receives 40 percent. Current law states they may use Program funds for the following purposes.

- Discretionary law enforcement services, including efforts to enhance public safety in the vicinity of the facility for which program funding is provided.

- Community outreach efforts that seek to address the concerns of residents and property owners within the one-quarter mile radius of the facility for which program funding is provided.

- Other community-based activities that the board of supervisors or city council, as applicable, believes will contribute to improved community relations regarding the facility for which program funding is provided.

Staff Comments. The program has received three applications to date and one of the impediments to additional interest appears to be the restricted use of the funds. The proposed language would make fund use more flexible while retaining the intended goals of the program.

Staff Recommendation. Adopt proposed trailer bill language.