Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Michael J. Rubio, Chair
Senator Doug LaMalfa
Senator Noreen Evans

Agenda – Part A

Thursday, February 10, 2011
9:30 a.m. or upon adjournment of session
Room 112

Consultant: Brian Annis

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AGENDA – DISCUSSION / VOTE ITEMS

Issues Suggested for Discussion / Vote:

0520 Secretary for Business, Transportation and Housing

Department Overview: The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 16 departments, including the following large departments:

- Alcoholic Beverage Control
- Corporations
- Housing and Community Development
- California Highway Patrol
- Motor Vehicles
- Financial Institutions
- Real Estate
- Managed Health Care
- Transportation

In addition, the Secretary's Office oversees programs, including the following, which are budgeted directly in the Secretary's Office:

- Infrastructure and Economic Development Bank
- Film Commission
- Small Business Loan Guarantee Program
- Tourism Commission

Budget Overview: The Governor proposes total expenditures of $100.9 million ($4.2 million General Fund) and 60.7 positions for the Office of the Secretary – an increase of $78.2 million from the adjusted 2010-11 budget, and an increase of 1.5 funded positions. The primary reason for the year-over-year change is a one-time federal grant of $84.4 million to support the Small Business Loan Guarantee Program.

(See budget issue on next page)

Issue 1 – Small Business Loan Guarantee Program Expansion (BCP #2)

Governor's Budget Request. The Governor requests various budget changes related to a federal grant award that will result in one-time funding of $84.4 million for the Small Business Loan Guarantee Program (SBLG). This represents a significant expansion of the program which has typically had a trust-fund balance between $30 million and $40 million. The SBLG Program provides assistance to small businesses that may not qualify for traditional loans, by guaranteeing a portion of the loaned amount. The Administration requests to revert $20 million in General Fund support provided to the program one-time as part of the 2010 Budget Act (AB 1632, Chapter 731, Statutes of 2010). This reversion of $20 million is contingent on receipt of the federal funds. Finally, the Administration requests to double program staff from 1.5 positions to 3.0 positions.

Background / Detail. The Small Business Loan Guarantee Program is administered by 11 non-profit Financial Development Corporations (FDCs) via contracts with the State. In the current year, administration funding for the FDCs sum about $2.2 million ($1.7 million General Fund and $500,000 interest earnings) and the cost of the state oversight positions is about $150,000 (General Fund). The FDCs additionally charge fees in the range of 1 – 3 percent on the loan guarantees – which, with the federal money, could provide administration funding of the magnitude of $5 million depending on the volume of guarantees. The trust fund itself currently has a balance of about $44 million, and loan guarantees must not exceed five times the balance of the trust fund. In recent years, the SBLG Program has experienced significant fluctuation in General Fund support, trust fund earnings, and even a temporary suspension in new loan activities due to a prior reversion to the General Fund. The $84 million in federal funds would support the program at a new peak level, and would arrive in three parts over time – about $28 million should be received by the end of 2010-11.

Staff Comment: The federal funds allow the state to expand this program, which is popular in many communities, and at the same time realize a General Fund benefit of $20 million by reverting the augmentation provided last year. This baseline proposal appears to be a "win-win" for the program and State General Fund. The budget question that may merit consideration of the Subcommittee is what level of staffing is appropriate, and can additional General Fund relief be realized from substituting these new federal funds for base program funding and trust fund balances. Specifically:

- Can the state perform program oversight with fewer than 3.0 positions?
- Can the base $1.9 million General Fund support for state administration and the FDCs, be reduced or deleted and backfilled with federal funds?
- Can the base trust fund balance of $24 million be reverted to the General Fund immediately, or over time, and backfilled with federal funds?

LAO Recommendation: The Analyst recommends the Legislature:
a) Adopt the Governor's proposal to revert $20 million to the General Fund.

b) Adopt trailer bill language (TBL) to allow for the reversion of the additional General Fund dollars as the lines of credit and loans backed by roughly $24 million in state funds expire.
c) Reduce the request for additional staff by one and approve the 0.5 managerial position.
d) Consider eliminating the $1.7 million General Fund subsidy provided to FDCs.

Staff Recommendation:

a) Adopt the Governor's proposal (and LAO recommendation) to revert $20 million to the General Fund.
b) Reject LAO recommendation to adopt TBL to revert base trust fund assets (about $24 million) to the General Fund, but adopt TBL to direct that new loan guarantees use federal funds first.
c) Adopt the LAO recommendation to approve 0.5 new staff instead of 1.5 new staff.
d) Reject LAO recommendation to eliminate General Fund support for administration, and rather convert program administration funding to 50-percent General Fund and trust fund interest, and 50-percent federal funds, which is proportional to new program resources. (In the out-years, the administration funding share could be adjusted again to reflect program resources after the full federal grant is received. This staff recommendation would provide additional FDC administration funding over the base level for ramp-up, but still result in General Fund expenditure savings of about $1.0 million).

Vote:

8880 Financial Information System for California

Department Overview: The Financial Information System for California (FI$Cal), is an Enterprise Resource Planning (ERP) information technology (IT) project intended to replace, consolidate, and upgrade multiple legacy financial systems with a single system that would encompass the areas of: budgeting; accounting; procurement; cash management; and financial management. The development of FI$Cal resides with four “Partner Agencies”: the Department of Finance, the State Treasurer's Office, the State Controller's Office, and the Department of General Services. The FI$Cal system will be implemented in several phases, or “waves,” over the next decade. Budget Control Section 8.88 is a technical fiscal provision that directs special funds to the FI$Cal project and it will be made to conform to the final budget adopted under the 8880 budget items.

Budget Overview: The Governor proposes $70.8 million ($20.9 million General Fund) for continuing the FI$Cal project. This represents a year-over-year increase of $29.0 million ($5.2 million General Fund). Funded positions would grow from 62.1 to 95.9. The reason for the funding increase is that the project would be moving into the implementation stage with contract award to the vendor by December 31, 2011. The 12-year cost of fully implementing the project is estimated at $1.6 billion (both General Fund and other funds). The Administration is exploring financing options such as bonding and vender-financing to spread costs over a longer period.

(See budget issue on next page)

Issue 1 – FI$Cal Budget Request for 2011-12 (BCP #1)

Governor's Budget Request: As indicated above, the Governor requests $70.8 million ($20.9 million General Fund) for the project in 2011-12. The next 12 months are a critical time for the project, with key decision points on whether to move forward with the project as currently configured, how to finance the project, and to which vendor to award the integration contract. Current law (Government Code 15849.21) requires a report to the Legislature and 90-day review by the Joint Legislature Budget Committee (JLBC), after a contract is negotiated with the winning bidder, but prior to contract award – this report is anticipated in the July to September period of this year.

Project Timeline: Currently, three selected vendors are completing the "Fit-Gap," or stage I contract, which involves a review of potential gaps between the vendor's software and the state's business requirements. Project staff have also asked the three vendors to propose financing options and have held discussions with the State Infrastructure Bank (I-Bank) on financing options. The following are key upcoming dates:

- February 2011 – Financing proposals due from vendors.
- March 2011 – Fit-Gap or Stage I proposals due and begin negotiations.
- July 2011 – Select winning contractor and proceed on final negotiations.
- August 2011 – Deliver Special Project Report #4 and report to JLBC. The JLBC report is required to include costs and benefits of alternative approaches to the implementation of the FI$Cal system, including, but not limited to, a scaled-back version of the system.
- December 2011 (or earlier) – Award contract.
- January 2012 – Ramp up project and costs - $20 million for contractor, $12.7 for State Office of Technology Service, hire 33 new positions, and other activities included in the BCP.

Staff Comments: As the timeline above indicates, there will be new information and legislative reporting coming over the next few months and in the late summer / early fall. Some of this information will be available as the Subcommittee continues with budget hearings in April and May. Other information will only come after the budget is passed and the new fiscal year begins on July 1. Due to this schedule, the Subcommittee may wish to consider holding final action on the FI$Cal budget until later this spring. Because the report to the Legislature will not arrive until after the budget is passed, the Legislature will want to carefully consider budget bill language, or trailer bill language, to maintain appropriate legislative funding control after the proposed-contract detail is provided.

Staff Recommendation: Hold open for future consideration in the spring after further detail is available on alternative financing options.

California Alternative Energy and Advanced Transportation Financing Authority (0971)

Department Overview: The mission of the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) is to promote the prompt and efficient development of energy sources which are renewable or which more efficiently utilize and conserve scarce energy resources.

Budget Overview: The January Governor's Budget proposed total funding of $25.8 million (special funds and reimbursements) and 7.0 positions, an increase of $9.2 million and no change in positions. The year-over-year increase is primarily explained by the implementation of California Ethanol Producers Incentive Program (See Issue 1 on the following page for detail on this budget request).

Informational Note on the PACE Program: Due to a continuous appropriation enacted last year, the CAEATFA budget includes a $15 million transfer from the Renewable Resource Trust Fund related to the Property Assessed Clean Energy Program (PACE). The PACE Program provides up-front financing for renewable and energy efficiency-related upgrades to properties with a unique financing mechanism of a loan that is backed by the property and transferable to new owners if the property changes hands. Recent state legislation, SB 77 (Chapter 15, Statutes of 2010, Pavley), facilitated program participation by small local governments by allowing them to pool PACE bonds via CAEATFA before going to market. The federal government has recently determined that the PACE program presents significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The federal action effectively halted the operation of PACE programs while the legal issues now proceed to the courts. The Legislative Analyst recommends that the Legislature reverse the $15 million transfer, without prejudice, pending legal resolution of the issue that has suspended PACE activity. Staff suggests no action at this time, as the PACE issue may be addressed in a policy bill, or may be better informed by review in Budget Subcommittee #2 which oversees energy-related budget issues. This Subcommittee can revisit this issue at a later date as warranted.

(See budget issue on next page)

Issue 1 – AB 118 / Ethanol Producers Incentive Program (BCP#1)

Governor's Request: The Administration requests $9 million in reimbursement authority for CAEATFA to receive funds from the California Energy Commission (CEC) to perform activities related to the Alternative and Renewable Fuel and Vehicle Technology Program as authorized by AB 118 (Chapter 750, Statutes of 2007, Nunez). The specific program is the California Ethanol Producer Incentive Program whereby financial assistance is provided to ethanol producers selected by CEC to develop and commercialize advanced transportation technologies that meet advanced energy goals.

Background/Detail: AB 118 authorizes the CEC to implement various programs consistent with the most recently adopted Investment Plan for the Alternative and Renewable Fuel and Vehicle Technology Program. Pursuant to the 2010 Budget Act, CAEATFA and the CEC are entering into an interagency agreement that outlines the terms by which CAEATFA will assist CEC in implementing the ethanol incentive program goals. The interagency agreement is expected to have a 4-year term expiring in January 2015. The terms of the agreement require CEC to transfer a total of $15 million.

Staff Comment: The Governor's budget reflects a $15 million reimbursement in 2010-11 and a $9 million reimbursement in in the budget year. The two-year amount requested exceeds the interagency agreement by about $9 million – CAEATFA indicates this is proposed due to uncertainty about how funds will be distributed across fiscal years and to maximize flexibility.

LAO Recommendation: The Legislative Analyst recommends holding action on this item pending receipt of the 2011-12 AB 118 Investment Plan, which should be submitted to the Legislature this March. The Legislature has expressed a great deal of interest in the AB 118 program administered by CEC, and as such, has statutorily required that the CEC annually submit an AB 118 Investment Plan. This requirement is designed to improve the Legislature's oversight of the AB 118 program.

Staff Recommendation: Deny without prejudice to defer final consideration of this request to later this spring after the AB 118 report has been provided and reviewed.

Vote:

9620 Cash Management and Budgetary Loans

Department Overview: This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes [RANs]). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is scored as a budget solution, whereas cashflow borrowing is not counted as a budget solution (only a cash solution).

Budget Overview: The January Governor's Budget includes $300 million for interest costs on cashflow borrowing and $62 million for interest costs on budgetary borrowing – all General Fund. Of the cashflow amount, $100 million is for internal borrowing and $200 million is for external borrowing. Overall, expenditures in this item are up significantly – a total of $362 million is proposed for 2011-12, versus revised expenditures of $230 million in 2010-11. The year-over-year difference is primarily explained by the late budget last year that delayed the RAN sale until late in 2010. The Administration assumes the 2011-12 RAN sale will occur in July, resulting in a longer borrowing period and higher interest costs.

(see budget issues on next page)

Issue 1 – Intra-year Payment Deferrals / Cashflow Loans (Trailer Bill Language)

Governor's Proposal: The Administration requests statutory change that would allow intra-year cash payment deferrals in 2011-12, which would be similar to the authority granted for 2010-11. These deferrals represent an additional cashflow solution that have been necessary even after internal and external cashflow borrowing. The language also allows cashflow loans from two additional funds: the Immediate and Critical Needs Account in the State Court Facilities Construction Fund and the Hospital Quality Assurance Revenue Fund.

Background: Last year's cashflow measures were enacted by three bills: AB X8 5; AB X8 14; and AB 1624. The 2010-11 legislation provided approximately $5 billion in cashflow relief, and this year's proposal would be reduced to about $4.5 billion, due to the prohibition placed on borrowing from certain transportation funds by Proposition 22 of 2010. Last year's deferral plan was developed in consultation with higher education and local governments to minimize negative consequences. Finally, the plan includes triggers, such that the deferrals will not occur if the team of the State Treasurer, the State Controller, and the Director of Finance concur they are not necessary to maintain cash balances for the State. Cashflow loans are allowed for most special funds and existing statute requires repayment as needed for the program.

Detail: As indicated above, the Governor's proposal for 2011-12 is very similar to the enacted plan for 2010-11. The following are the major statutory components:

- K-12 Education – Permits up to 3 deferral periods not to exceed $2.5 billion at any one time. Includes a hardship-exemption process for certain local education agencies.
- Community College – Permits deferrals up to $200 million.
- California State University – permits deferrals up to $250 million.
- Cities and Counties – permits deferrals of specified payments to local governments not to exceed $1 billion.

Through existing administrative authority (no statutory change needed), the Administration could also defer $500 million to the University of California and about $81 million of CalWORKs administrative funding to counties.

Staff Comment: The Department of Finance should explain the need for the cash deferrals in 2011-12 and explain how the 2011-12 plan would compare and contrast to the 2010-11 plan. While cash deferrals to other government units are not desirable, they appear necessary for 2011-12 to avoid payment deferrals to private vendors and taxpayers (such as vendor payments and delayed tax refunds).

Staff Recommendation: Approve the placeholder trailer bill language.

Vote:

Issue 2 – Repayment of Special Fund Loans (Governor's Budget)

Governor's Proposal: As indicated in the introduction to this issue, the January Governor's Budget requests $62 million General Fund to pay interest on outstanding special-fund loans – this is budgeted in item 9620. Interest is only repaid when the loan principal is repaid. The amount of principal repaid is $566 million; however, principal repayment is budgeted as a revenue adjustment instead of an expenditure. The amount of total special fund loans outstanding as of December 31, 2010, is $2.6 billion, according to the Department of Finance. This table below reflects the Administration's planned special-fund loan repayments in 2011-12 (dollars in millions).

Fund Name	Principal	Interest
Accountancy Fund	$10,000,000	$84,521
Contractors' License Fund	10,000,000	727,003
State Dentistry Fund	3,000,000	739,688
Occupational Therapy Fund	640,000	79,627
Enhanced Fleet Modernization Subaccount	20,000,000	169,041
Public School Planning, Design, and Construction Review Revolving Fund	10,000,000	727,003
Housing Rehabilitation Loan Fund	9,200,000	965,526
Rental Housing Construction Fund	500,000	72,762
State Highway Account, State Transportation Fund	200,000,000	19,566,247
Bicycle Transportation Account, State Transportation Fund	6,000,000	586,987
Local Airport Loan Account	7,500,000	733,734
Motor Vehicle Fuel Account, Transportation Tax Fund	8,000,000	782,650
Environmental Enhancement and Mitigation Program Fund	4,400,000	430,457
Historic Property Maintenance Fund	3,000,000	293,494
Pedestrian Safety Account, State Transportation Fund	1,715,000	167,781
Motor Vehicle Account	40,000,000	338,082
Beverage Container Recycle Fund	88,000,000	21,697,524
Tire Recycling Management Fund	27,097,000	2,914,531
Recycling Market Development Revolving Loan Subaccount	1,853,000	248,918
Universal Lifeline Telephone Service Trust Administrative Committee Fund	45,000,000	3,271,512
Deaf and Disabled Telecommunications Program Administrative Committee Fund	30,000,000	2,181,008
Teleconnect Fund	40,000,000	5,373,288
	$565,905,000	**$62,151,384**

Staff Comment: The Department of Finance should present their special-fund loan repayment plan and the LAO should comment. Generally, decisions about special fund loans will be made in the budget Subcommittees by subject-matter area, although the 9620 Budget Item should be made to conform.

Governor's February 9, 2011, Budget Revision: On February 9, 2011, Governor Brown canceled the sale-leaseback of 11 state office buildings and proposed to backfill for the General Fund loss with new special fund loans, repayment deferrals, and other measures. The new solutions total $1.2 billion. Full detail on that proposal was not available at the time this agenda was finalized, but staff has asked the Department of Finance to present a summary of the revised plan at the hearing.

Staff Recommendations: Take no action, this is an informational issue.