Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Gloria Negrete McLeod, Chair
Senator Doug La Malfa
Senator Noreen Evans

Thursday, March 8, 2012
10:30 a.m. or upon adjournment of session
Room 112

Consultant: Brian Annis

State and Local Finance / Business Development

Item Number and Title **Page**

Proposed Vote-Only Issues:

Proposed Discussion / Vote Issues:

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Issues Suggested for Vote Only:

State Treasurer's Office and Related Financing Boards

Department Overview: The Governor's Budget includes stable funding for State Treasurer and the 12 related Boards, Committees, and Authorities. Only three budget change proposals were submitted for these entities and none include General Fund costs. No concerns have been raised with these proposals, and they are recommended for approval as "vote-only issues."

Budget Change Requests: The Governor's Budget includes the following three budget augmentation requests:

1. The California Tax Credit Allocation Committee (CTCAC) requests two permanent new positions, and $247,000 from special funds, to perform Internal Revenue Service (IRS) code compliance monitoring workload. The CTCAC administers both federal and state low-income housing tax credit programs that require ongoing monitoring of the housing facilities and the low-income qualifications of the residents.
2. The California Tax Credit Allocation Committee also requests $473,000 from special funds to contract for asset management services for 63 low-income housing projects funded by the American Recovery and Reinvestment Act (ARRA). This is a new workload specifically related to the ARRA requirements.
3. The California School Finance Authority requests no new funding, but the establishment of one position to be funded within existing resources. The position would be formalized in lieu of using temporary help authority. This is a technical BCP to adhere to State personnel rules and regulations in a unique circumstance.

Staff Comment: No concerns have been raised with these budget requests.

Staff Recommendations: Approve the Treasurer's budget requests.

Vote:

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 12 departments, including the following large departments:

- Alcoholic Beverage Control
- Corporations
- Housing and Community Development
- Transportation (Caltrans)
- Financial Institutions
- Real Estate
- California Highway Patrol
- Motor Vehicles

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 $15.6 million ($2.5 million General Fund) and 62.0 positions for the Office of the Secretary – which is similar to the current-year budget after one-time adjustments for a federal grant to the Small Business Loan Guarantee Program. When all departments in the Agency are included, total proposed expenditures for 2012-13 are $11.3 billion including: General Fund ($558 million); special funds ($8.0 billion); and bond funds ($2.7 billion); but excluding reimbursements from local government which add another $1.5 billion to the Caltrans budget.

The Administration also submitted a Budget Change Proposal that describes its budget adjustments related to last year's "Workforce Cap" position reduction – the Legislature had approved statewide savings for the Workforce Cap, but last year's action did not include position detail. The Agency eliminated a Loan Officer Specialist position working for the Infrastructure Bank, and an Office Technician position. The Agency believes the elimination of these two positions will not affect the ability of the Agency to perform its duties. The Agency also eliminated an exempt Undersecretary for International Trade; however, the Governor has included that role in his proposal to fully staff the Governor's Office of Business and Economic Development (GO Biz), which is discussed later in this agenda. The overall Workforce Cap savings are $143,000 in 2011-12 and $268,000 in 2012-13 and ongoing (special funds and reimbursements, no General Fund).

(See budget issue on next page)

Issue 1 – Major Reorganization of the Agency

Governor's Budget Request. The Governor's January Budget Summary proposes major reorganization of State government – in the case of the BT&H Agency, the Agency would cease to exist and current functions would be shifted or recreated in three separate organizations. The transportation functions would move to a newly-created Transportation Agency; the housing and business regulatory functions would be merged with certain business regulatory and consumer protection functions currently in the State and Consumer Services Agency to create a new Business and Consumer Affairs Agency; finally, the economic development functions would move to the Governor's Office of Business and Economic Development (GO Biz). In addition to these shifts, several existing departments would be merged together or merged with departments currently in other agencies. A chart on the following page details the proposed reorganization.

Detail and Process. Detail on the reorganization proposal is still pending from the Administration in terms of statutory language and implementation dates. However the Administration released information on March 2 that suggested the reorganization associated with the BT&H Agency would be submitted to the Little Hoover Commission for review and then submitted to the Legislature as a package to become effective unless rejected by the Legislature. Depending on when the proposals are submitted to Little Hoover, the timeline for legislative action may be pushed beyond enactment of the 2012 Budget in mid-June. The Administration suggests that even if the reorganization is approved, no budget action would be needed until the 2013-14 budget.

Rationale for Reorganization: Generally, the rationale for government reorganization is either, or a combination of, efficiency and effectiveness:

- **Efficiency.** Some reorganizations result in the elimination of duplicative functions or result in other efficiencies that produce either budget savings or cost avoidance.
- **Effectiveness.** Some reorganizations do not result in either cost savings or position savings, but instead allow the State to be more effective and focused in providing services to the public.

The Administration does not score any budget savings for reorganizations related to the BT&H Agency for 2012-13. The Administration provided a chart that indicates no savings for 2012-13 but savings "to-be-determined" for 2013-14 and thereafter. While some out-year savings may be outlined later by the Administration, it appears the primary goal of this reorganization is to achieve more effectiveness in the provision of state services by consolidating like functions and allows Agency Secretaries to focus on better defined goals such as transportation, or business regulation and consumer protection.

BT&H Agency Proposed Reorganization

Current BT&H Agency		Proposed Agency
		Proposed Transportation Agency
Transportation-Related		
* California Transportation Commission	→	California Transportation Commission
CA Dept of Transportation (Caltrans)	→	CA Dept of Transportation (Caltrans)
* High-Speed Rail Authority	→	High-Speed Rail Authority
Board of Pilot Commissioners	→	Board of Pilot Commissioners
California Highway Patrol (CHP)	→	California Highway Patrol (CHP)
Dept of Motor Vehicles (DMV)	→	Dept of Motor Vehicles (DMV)
Office of Traffic Safety (OTS)	↗	(OTS merged into DMV)
		Proposed Business& Consumer Affairs Agency
Housing-Related		
Housing and Community Dev. (HCD)	→	Housing and Community Development
CA Housing Finance Agency (CalHFA)	↗	(CalHFA merged into HCD)
Business-Related		
Alcoholic Beverage Control (ABC)	→	Alcoholic Beverage Control (ABC)
ABC Appeals Board	→	ABC Appeals Board
Dept of Financial Institutions (DFI)	→	Department of Business Oversight
Corporations	↗	(merged DFI and Corporations)
Real Estate Appraisers	→	Department of Consumer Affairs (DCA)
Real Estate	↗	(Real Estate merged into DCA)
		Some other Departments currently in the State and Consumer Svcs Agency
		Governor's Office of Business and Econ Dev (GO Biz)
Economic Dev. Offices within BT&H		
Infrastructure Bank	→	Infrastructure Bank
Film Commission	→	Film Commission
Tourism Commission	→	Tourism Commission
Small Business Loan Program	→	Small Business Loan Program
California Welcome Center Program	→	California Welcome Center Program

* Functionally within BT&H, but statutorily independent.

Hearing Questions: The Administration is still working on details, but since the reorganization plan was included in the January Governor's Budget Summary, the Administration should be able to respond to the opportunities and goals they see related to the proposal. The Subcommittee may want to hear from the Administration on the following questions:

1. *What are some of the deficiencies with the current BT&H Agency that the Administration believes can be addressed with the reorganization?*

2. *What level of out-year saving are anticipated with the proposal and is the rationale for the proposal cost savings or performance?*

3. *Since the Administration indicates it will submit these reorganization proposals to the Little Hoover Commission, does the Administration anticipate the need for reorganization-related adjustments to the 2012 Budget Act, or would conforming budget action not be needed until the 2013 Budget Act?*

Staff Comment: The proposed budget for the Office of the Secretary for the BT&H Agency does not reflect any budget adjustments for reorganization, and the Governor's reorganization may not take effect until July 1, 2013. Since no concerns have been raised with the baseline BT&H budget, the Subcommittee may wish to consider approving the BT&H budget as proposed.

Staff Recommendation: Approve the baseline BT&H Agency budget (excludes any action on reorganization).

Vote:

0509 Governor's Office of Business and Economic Development (GO Biz)

Department Overview : The Governor's Office of Business and Economic Development (GO Biz) is a new entity in State government. It was first established by Executive Order S-05-10 in April 2010, and established in statute effective January 1, 2012, via enactment of AB 29 (Statutes of 2011, J. Perez). The original organization was formed by borrowing positions and programs from other departments and agencies. With AB 29, and enactment of the 2012-13 budget, the entity will for the first time receive a specific stand-alone budget act appropriation. The Office is intended to be a high-profile point-of-contact for businesses and the economic development community, and an advocate for California as a place to grow businesses and jobs.

Budget Overvie w: The Governor proposes total expenditures of $4.1 million General Fund and 28 positions for GO Biz, effective with the 2012-13 budget. Prior to the 2012-13 proposal, the organization borrowed positions from other departments, so the staffing and costs have not been transparent in the budget. With AB 29 and this budget request, the Administration is indicating that the current baseline staffing has been 22.3 positions and $3.3 million ($418,000 General Fund). For 2012-13, funding would increase by $761,000 and 5.7 positions. Additionally, while many of the borrowed positions were from special fund departments, the Administration indicates as a permanent stand-alone entity, it would be inappropriate to use special funds and that all funding should be General Fund – which results in a net new General Fund expenditure of $3.6 million (but a net special fund reduction of $3.3 million).

Reorganization Plan: As indicated in the Business, Transportation, and Housing Agency (BT&H) section of this agenda, The Governor's reorganization plan would further augment the staff and functions of GO Biz by incorporating existing business promotion offices within the BT&H Agencies. Specifically, total funding of $12.2 million ($2.5 million General Fund) and 40 positions would move from the BT&H Agency to Go Biz. The offices are: the Film Commission, the Infrastructure and Economic Development Bank, the Small Business Loan Guarantee Program, the Tourism Commission, and the Welcome Center Program. The Administration now indicates this reorganization plan will be submitted to the Little Hoover Commission prior to Legislative Action – so no reorganization budget change is proposed for GO Biz at this time, and not expected until the 2013-14 budget.

(See budget issue on next page)

Issue 1 – Establishment of the Stand-alone GO Biz Budget (BCP #1)

Governor's Budget Request: The Governor's January Budget proposes a budget appropriation of $4.1 million General Fund and 28 positions for the first year of stand-alone budgeting of GO Biz. The expense is partially offset by reducing the budgets of various departments that had in the past loaned funding and positions for GO Biz - $2.9 million special funds and $418,000 General Fund and 23.3 positions are eliminated from these departments' budgets.

Prior Support for GO Biz: In a February 2010 report, the Little Hoover Commission concluded that the State should reestablish a more prominent role of leadership in the area of business development to fill the void created by the 2003 elimination of the Technology, Trade, and Commerce Agency. Governor Schwarzenegger soon thereafter shifted existing State staff to create such an entity by executive order. The Legislature approved the statutory framework for this organization with large bipartisan majorities by passing AB 29 in 2011.

Structure of GO Biz: The Administration budgets GO Biz in three components:

- **CalBIS:** $1.7 million and 11.4 positions would be for the California Business Investment Services Program (CalBIS), which would serve employers, corporate executives, business owners, and site location consultants who are considering California for business investment and expansion.
- **Office of Small Business Advocate:** $459,000 and 2.8 positions would be for the Office of Small Business Advocate, which would serve small employers with advocacy and technical assistance.
- **GO Biz:** $1.9 million and 12.4 positions for the remaining functions of communications and policy, international trade and export promotion, and administration.

Most GO Biz staff would be located in Sacramento, but the organizational plan calls for two employees in the San Francisco Bay Area, two employees in Los Angeles, and one employee in the Inland Empire.

Appropriate Staffing and Funding for GO Biz: Given prior support for the GO Biz concept, review of the budget request may focus more on the size of the office and staffing level, instead of the value of having such an office. When AB 29 was adopted, the bill analysis anticipated a budget in the range of $2.3 million, but $4.1 million is requested by the Governor. Additionally, the budget request sets position funding at the highest step for each pay range instead of the more common mid-point level. The Administration indicated that it would reexamine the funding for positions in the budget request, and should be able to explain their position at the hearing.

Hearing Questions: The Subcommittee may want to hear from the Administration on the following questions:

1. *Why does the requested funding and the number of positions exceed the levels present when the organization was operating under the executive order, and why does funding exceed the level discussed when AB 29 was adopted?*

2. *Why is position funding set at the maximum pay level, instead of the more-common mid-point level?*

Staff Comment: At the time this agenda was finalized, the Administration was re-evaluating its budget request to see if the position cost is overstated. To the extent that issue is not satisfactorily resolved, this item should be held open and brought back at a later hearing.

Staff Recommendation: Hold open - unless the Subcommittee is satisfied with the cost justification provided by the Administration at the hearing.

Vote:

9210 Local Government Financing

Department Overview: The 9210 budget item includes several programs that make State subventions to local governments. The payments include $2.1 billion General Fund for constitutionally-required repayment of 2009-10 "Prop 1A" borrowing from local governments; a small subvention related to former Redevelopment Agencies (RDAs) to help retire a portion of outstanding debt that was backed by the personal property tax – about $500,000, and a new subvention of $4.4 million General Fund proposed this year for Mono and Amador counties.

Budget Overview: The proposed budget for the 9210 item is $2.1 billion General Fund. Year-over-year comparisons show a major increase in expenditures as Prop 1A borrowing was $91 million in 2011-12 and will be $2.1 billion in 2012-13. Prop 1A debt will fully be repaid in 2012-13, so there is no ongoing cost. Additionally, some public safety grants were included in this item in prior years, but that funding was shifted with the 2011 Public Safety Realignment legislation and is now funded with the new local revenues instead of State grants.

(See budget issue on next page)

Issue 1 – Reimbursements to Amador and Mono Counties

Governor's Request: The Governor proposes a new General Fund subvention of $4.4 million to backfill Mono and Amador counties due to unique circumstances that reduced property tax directed to those county governments and cities within those counties in 2010-11. The revenue loss is understood to also have occurred in 2011-12 and will continue into 2012-13 and likely beyond, but the Administration indicates it is undetermined at this time whether its proposal is one-time or ongoing.

Background / Detail: Legislation enacted early in the Schwarzenegger Administration shifted local property tax from schools to cities and counties to accommodate two State fiscal initiatives. Schools were then backfilled with State funds. Overall, the fiscal changes resulted in a large net revenue gain for cities and counties as the replacement revenue streams have grown faster than the relinquished revenue streams. However, for Mono and Amador counties, unique circumstances reportedly reversed this outcome in 2010-11 and it is possible this outcome could occur for a few additional counties in the future.

- **Financing Economic Recover y Bonds (ERBs):** In the 2004 primary election, voters approved Proposition 58, which allowed the State to sell ERBs to pay its accumulated budget deficit. The local sales tax for cities and counties was reduced by one-quarter cent and the State sales tax was increased by one-quarter cent to create a dedicated funding source to repay the ERBs. Property tax was redirected from schools to cities and counties, and the State backfilled schools via the Proposition 98 funding guarantee. This financing mechanism is sometimes called the "triple flip," and was anticipated to hold local governments harmless. When the ERBs are repaid in 2016-17 (or earlier), the local sales tax rate is restored.
- **Backfilling for the V ehicle License Fee (VLF) Tax Cut** : Also in 2004, the Legislature enacted the "VLF Swap" to provide a more reliable funding mechanism to backfill cities and counties for the local revenue cut by the State when the VLF tax on motor vehicles was reduced from 2.0 percent of a vehicle's value to 0.65 percent of a vehicle's value. Here again, the state redirected property tax from schools to cities and counties and backfilled schools with State funds.
- **Problem for Mono and Amador**: The funding mechanism stopped fully working for Mono and Amador counties reportedly in 2010-11 due to all the schools in those counties becoming "basic aid" schools. Basic aid schools receive sufficient local property tax to fully fund the per-student amounts required by the Proposition 98 guarantee and therefore the State's funding is minimal. Due to this "basic aid" situation, current law would not backfill schools for any property tax shifted to cities and counties and county auditors have reportedly reduced or discontinued the "AB 8" shift of property tax from schools to those cities and counties. The estimated loss for the two counties in 2010-11 is $4.4 million. Conversely, in a non-"Test 1" Proposition 98 year, the State would realize a savings from not having to backfill schools – but

2012-13 appears to be a Test 1 year.

Issues to Consider: The financing shifts and educational financing provisions are complex, and perhaps not entirely relevant to making a determination on this budget request. The Subcommittee may instead want to focus on some broader ideas and issues:

- **Revenue growth uncertainty:** The funding shifts did include uncertainty and risk, as the relative growth of various revenue streams over many years was unknown. On a statewide basis, data suggests most counties – perhaps as many as 56 of 58 counties - have received a net benefit from the shifts. Since 2010-11, reportedly Mono and Amador have not seen net benefits. Individual county estimates of benefits or costs are not currently available, but the two counties have estimated the isolated effect of the property tax shift at $4.4 million.
- **No backfill guaranteed in the orig inal legislation, but the Mono and Amador outcome w as not anticipated:** The enacting legislation did not include provisions for the State to backfill locals with new subventions if the baseline funding mechanism proved to be insufficient to maintain city and county funds. At the time of the legislation, stakeholders were likely aware of the risk of variable levels of growth for different revenue streams, but may not have anticipated this outcome of all schools within the county becoming "basic aid." Since this outcome may not have been foreseen by the State or local governments at the time of bill enactment, does the State have a responsibility to backfill for this revenue loss?
- **Budget challenges in most cities and counties:** Since many cities and counties are continuing to experience budget shortfalls, should the Legislature consider the fiscal condition of the two counties relative to other counties as a factor in the determination. For example, has the decline in revenue for these counties since 2007-08 exceeded the statewide average?
- **Timing of the subvention:** If the Legislature determines a subvention is appropriate, should the Legislature appropriate for revenue loss through 2012-13 (maybe funding at a level of $13.2 million), or conversely decide to fund, but defer reimbursement to later in the fiscal year.

Staff Comment: The Department of Finance and the Legislative Analyst's Office will both be available at the hearing to respond to questions, and staff understands that representatives for Mono and Amador counties will also be present.

Staff Recommendation: Hold open for action later in the budget process as more data may be available on this issue, and the amount of General Fund revenues for 2012-13 is known with greater certainty.

8880 Financial Information System for California (FI$Cal)

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 has been in development for several years, but is now at a critical juncture because the Administration selected a contractor or "systems integrator" on March 1, 2012, to implement the system. To move forward with the contract and expenditures, legislative approval is required. Included in this budget item is funding for the contract staff and State staff that manage the project, and funding for the selected systems integrator, which is Accenture. Accenture would implement this ERP IT system using Oracle's PeopleSoft software.

Budget Overview: For 2012-13 expenditures, the Governor proposes $89.0 million ($53.5 million General Fund) for the FI$Cal project. The full multi-year cost from 2012-13 through 2017-18 would be $522 million, with $246 million of that General Fund. While the cost is large, it is significantly reduced from early costs estimates of $1.6 billion. The Administration has explored financing options such as bonding and vender financing to spread costs over a longer period, but recommends pay-as-you-go funding instead to reduce interest costs and delay. When costs already incurred are included, the Administration pegs the cost of the project at $616.7 million.

Current Statutor y Provisions for FI$Cal / JLBC Review : Current law (Government Code 15849.21, as added by AB 1621, Statutes of 2010) requires a report to the Legislature and 90-day review by the Joint Legislature Budget Committee (JLBC), after a contract is negotiated with the selected bidder, but prior to contract award. This report was submitted to JLBC on March 2, 2012. Later this spring, the Legislature will inform the Administration of its decision on this project: via the JBLC for the contract award, and via the Budget Committee for the funding request. Subcommittee staff will coordinate with JLCB staff during the concurrent reviews of the proposed contract and proposed budget.

(See budget issue on next page)

Issue 1 – FI$Cal Budget Request (BCP #1 & Finance Letter #1)

Governor's Budget Request: As indicated, for 2012-13 expenditures, the Governor proposes $89.0 million ($53.5 million General Fund) for the FI$Cal project. The full multi-year cost from 2012-13 through 2017-18 would be $522 million, with $246 million of that General Fund. When prior expenses are included, the Administration scores the total project cost at $616.8 million – this cost breaks down $295.7 million for project staff (both state and contract staff), $213.1 million for the Accenture contract, and $19.0 for state data center services. Upon completion, ongoing annual operations and maintenance costs would be $32.5 million. No funding is included for "program staff" which would be staff at various departments working to implement the system – departments would instead have to absorb this cost and redirect existing staff. In Finance Letter #1, the Administration requests budget approval for full multi-year cost of this project.

Rationale for the Project: The current State financial systems are old and inefficient – they require more staff time to complete the same work, they have a limited ability to provide real-time fiscal information, and they lack tools necessary to effectively manage procurement and implement fiscal performance reporting. Departments maintain many incompatible systems and collection of statewide data involves redundant data entry, which delays and adds costs to calculating statewide numbers.

The Administration hired an external consultant to quantify the inefficiencies in the current State systems that would be resolved with an ERP solution. The consultant estimated that upon full implementation of FI$Cal, the State would see annual savings of $415 million as follows:

- **Process cost savings ($173.2 million):** This would be savings from reduced labor costs achieved through attrition as existing tasks are streamlined and could be achieved with fewer staff resources.
- **Technology cost savings ($28.0 million):** This would be savings related to operation and maintenance of existing IT systems that could be retired if FI$Cal were implemented.
- **Procurement effectiveness savings ($213.4 million):** This would be savings that would come from better procurement management and consolidated purchasing.
- **Risk reduction / system failure costs (not quantified):** This would be savings from retiring legacy fiscal systems that are at risk of failure due to insufficient state staff or vendors available to maintain obsolete systems.
- **Business performance improvement (not quantified):** This would be savings from using the FI$Cal system as a decision tool to better manage and prioritize limited state dollars, including performance budgeting.

Baseline and Alternatives for Implementing FI$Cal: The Administration proposes a **"phased rollout of functionality "** whereby all FI$Cal components (budgeting, accounting, purchasing, etc.) are implemented at the same time, but rolled out department by department over 5 years. The Administration believes this approach would result in a cheaper, quicker, and less-disruptive implementation than the following other approaches:

- **Function Phasing** – implement subcomponents individually statewide one at a time – for example, implement budgeting statewide and after that is complete, implement procurement statewide.
- **Department Phasing** – implement FI$Cal for a distinct group of departments and fully complete implementation and evaluation before moving on to a second group of departments.
- **Managed Service Models** – implement FI$Cal with a revised IT ownership structure whereby the State does not own either the infrastructure or the software. Instead the State would purchase software as a service and pay to access the functionality over a network.

The Administration additionally notes a change in the implementation model would result in the need for a new procurement which, by itself, would delay the project and increase costs.

Baseline and Alternatives for Funding FI$Cal: The proposed financing for FI$Cal is **pay-as-you-go** using General Fund, special funds, and federal funds, in proportion to each department's funding and cost share of the project. The Administration requests trailer bill language to specify FI$Cal is a central service department in order to recover the federal funding share, but also indicates this recovery of federal funds cannot occur until the project is completed. The below table is the project's proposed multi-year funding approach:

Baseline FI$Cal Cost by Fund
(dollars in millions)

Year	General Fund	Special Funds	Federal Funds	Total
2012-13	$53.5	$35.5	$0.0	$89.0
2013-14	50.8	33.8	0.0	84.6
2014-15	61.2	40.7	0.0	101.9
2015-16	78.1	51.9	0.0	130.0
2016-17	50.6	33.6	0.0	84.2
2017-18	19.5	13.0	0.0	32.5
Recovered Federal Funds	-67.8	0.0	67.8	0.0
Totals	**$246.0**	**$208.4**	**$67.8**	**$522.2**

The Administration considered and rejected two alternative financing approaches – vendor financing and bond financing. The common problems with these approaches, according to the Administration, are that only about half of the overall cost would be eligible for financing and interest charges would increase multi-year costs by about $70 million.

- **Vendor Financing:** With this approach, the State would pay the vendor share of costs over a longer period and incur interest costs. The Administration indicates if this approach were to be used, federal reimbursement for a portion of project costs would not be possible, and the General Fund and State special funds would incur the federal cost share of $67.8 million.
- **Bond Financing:** With this approach, the State would borrow itself to fund the project and incur interest costs. A State bond sale may take time to implement and could delay the project.

Staff Alternative Pay-as-you-go Financing: Given the difficult budget year, but the expectation that budget tightness will lessen in the out-years, the Legislature may want to consider a pay-as-you-go funding approach where special fund payments are accelerated and General Fund payments are decelerated. The table below shows how this might work – in 2012-13 there would be no General Fund expenditures and special funds would cover the $89 million cost. In 2013-14, the funding split would be unchanged from the baseline plan, with the General Fund share at $50.8 million. In 2014-15 through completion in 2017-18, the General Fund would pay a greater share and the special funds a lesser share to make up for the 2012-13 year. Overall expenditures by year would be unchanged.

Staff-alternative FI$Cal Cost by Fund
(dollars in millions)

Year	General Fund	Special Funds	Federal Funds	Total
2012-13	$0.0	$89.0	$0.0	$89.0
2013-14	50.80	33.80	0.00	84.60
2014-15	76.84	25.06	0.00	101.90
2015-16	98.05	31.95	0.00	130.00
2016-17	63.52	20.68	0.00	84.20
2017-18	24.49	8.01	0.00	32.50
Recovered Federal Funds	-67.80	0.00	67.80	0.00
Totals	**$246.0**	**$208.4**	**$67.8**	**$522.2**

Additional Reviews of FI$Cal Are Still Pending: At the time this agenda was finalized, the Legislative Report had only been available for 72 hours and the Finance Letter had only been available for 24 hours. So Committee staff and the Legislative Analyst's Office (LAO) are still in the first stages of review. Statute also directs the

Bureau of State Audits (BSA) to review and report on the status of the FI$Cal projects at least annually. It is likely both the LAO and BSA will be able to provide the Committee more detailed reviews and recommendations at future hearings – both will also be available at this hearing to answer questions. Even though the information from the Administration is recent and has not been comprehensively reviewed, staff recommended inclusion of this issue at this early hearing due to the importance of the issue and high cost of the project.

Hearing Questions: The Subcommittee may want to hear from the Administration on the following questions:

1. *During this difficult budget time, when many important programs are being severely cut, why does the Administration believe it is critical to move forward with FI$Cal?*

2. *The Administration indicates the project will produce out-year annual savings of $415 million starting in 2018-19, which would quickly compensate for the cost of the project – would these savings be realized in the budget via expenditure reductions, or would departments retain these savings in their budgets to grow their programs or to offset new workload pressures?*

3. *The 2012-13 General Fund cost of FI$Cal is $53.4 million – in this difficult budget environment can special funds front some of this initial cost with the appropriate General Fund contribution recovered over time?*

Staff Comments: The Legislature has supported development of the FI$Cal project - providing for expenditures of $94.5 million ($17.7 million General Fund) through June 30, 2012. Despite the sunk costs already incurred for the project, the Legislature will have to weigh the value of the FI$Cal project relative to other spending priorities. If the Legislature agrees the project is of high criticality, it will then have to select a funding approach that conforms to budget constraints of 2012-13.

Staff Recommendation: Hold open for further consideration at a future hearing after the Legislative Analyst and the State Auditor are able to complete a full review of the revised project plan and costs.

Debt Service General Obligation Bonds and Commercial Paper (9600)

Department Overview: Debt service payments are continuously appropriated, and therefore not appropriated in the annual budget bill. This item in the Governor's Budget displays the estimated debt service costs for each General Obligation bond (GO bond). Some bond costs are offset by special funds or federal funds – primarily by the transportation debt service fund. Other bonds are "self-liquidating," or have their own dedicated revenue (i.e., the Economic Recovery Bonds [ERBs] receive a quarter-cent of the sales tax) – the self-liquidating bonds are not included in this item.

Budget Overview: The January Governor's Budget includes $4.6 billion in General Fund costs for GO bond debt service and related costs, or a total of $6.1 billion when the cost of Economic Recovery Bonds is included. In addition to this amount, $717 million in debt costs are funded from special funds (i.e., $703 million from transportation special funds is used to pay transportation-related bond debt). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide $352 million in 2012-13.

Governor's Budget for GO Bond Debt
(Dollars in millions)

	2010-11 Actual Cost	2011-12 Estimated Cost	2012-13 Estimated Cost
General Fund cost	$4,747	$4,649	$4,612
Other funds cost	732	679	717
Federal subsidy (Build America Bond Program)	298	351	352
TOTAL Item 9600	**$5,777**	**$5,679**	**$5,681**
Economic Recovery Bonds (ERBs, not included above because indirect GF cost)	$1,263	$1,341	$1,465

According to the Administration, the State has $81.0 billion in outstanding GO bond debt (including self-liquidating bonds like the Economic Recovery Bonds). Another $35.3 billion in bonds are authorized, but unissued. In most instances, bonds are sold at different lengths of maturity such that repayment is spread over about 30 years.

General Obligation Bonds Authorized But Not Issued
(Dollars in millions)

Bond Program	Unissued Amount
Prop 1B of 2006: Transportation	$11,080
Prop 1A of 2008: High Speed Rail	9,448
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	3,362
Prop 84 of 2006: Safe Drinking Water	2,957
Prop 71 of 2004: Stem Cell Research	1,873
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,819
Prop 46 of 2002 & Prop 1C of 2006: Housing	1,392
All other	3,372
TOTAL $35,303	

Budget and Bonds: Paying GO bond debt is a significant General Fund expense of about $6.1 billion; however, the use of bonds to accelerate capital projects is a commonly-used practice of government entities. To the extent bond costs do not exceed a government's long-term ability to fund other commitments, they allow the public to enjoy the benefits of infrastructure investment more quickly. Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. The bonds have allowed the state to invest in infrastructure while the need for economic stimulus is most acute, while borrowing costs are low, and while construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. A $1 billion bond generates annual bond debt costs of about $65 million over a 30-year period. That bond cost crowds out alternative expenditures over the life of the bond. The Legislature can prioritize or limit bond funding through the budget process as overall expenditures are prioritized.

Management of Bonds: As the State's cash situation deteriorated with the most recent recession, the Administration changed the methodology for managing bond cash. Prior to the recession, reserve cash funded project costs in advance of bond sales, and then bond sales replenished cash reserves. When reserve cash declined, the state had to instead sell bonds in advance of expenditures. Due to project expenditures happening slower than anticipated at the time of bond sales, large bond cash balances have developed – about $9.7 billion as of December 2011. Last year, the Administration implemented a plan to utilize commercial paper to aid cashflow, and reduce the need to carry large bond cash balances. Progress has been made to reduce bond cash, but balances are still higher than desired.

Issue #1 – Bond Cash Plan for 2012-13 (Governor's January Budget)

Governor's Proposal: The Administration proposes both a spring and fall bond sale for 2012. A total of $2.4 billion in bonds would be sold this spring, and an additional $2.9 billion would be sold in the fall. The net new General Fund cost related to these bond sales is $118 million in the 2012-13 budget, with an additional $71 million in bond costs funded from transportation special funds. With cash on hand and 2012 bond sales, a total of $15.0 billion would be available to fund bond projects in January 2012 through June 2013.

Detail: The table below displays bond cash on hand (from prior bond sales) as of December 2011, as well as the new cash that would come from bond sales in 2012, for the major GO bonds. The December 2011 bond cash balance of $9.7 billion represents progress in reducing the balance which was as high as $13.3 billion in December 2010. However, the Administration's goal was to reduce bond cash to $3 billion by June 2012, and it does not appear that goal will be met. Reducing cash balances will reduce short-term General Fund costs.

General Obligation Cash Proceeds
(Dollars in millions)

Bond Program	Cash as of Dec 2011	Planned 2012 bond sales	Total cash through June 2013
Prop 1B of 2006: Transportation	$2,241	$2,375	$4,616
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	1,501	1,835	3,336
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,445	211	1,656
Prop 84 of 2006: Safe Drinking Water	1,291	36	1,327
Prop 46 of 2002 & Prop 1C of 2006: Housing	654	282	936
Prop 71 of 2004: Stem Cell Research	187	338	525
Prop 1A of 2008: High-Speed Rail	216	61	277
All others	2,166	122	2,288
TOTAL $9,701		**$5,260**	**$14,961**

Hearing Questions: The Administration should be prepared to discuss their overall plan for GO bonds in 2012-13. Individual bonds will be discussed in more detail by subject matter in this subcommittee and other subcommittees as hearings progress this spring. The Subcommittee may want to hear from the Administration on the following questions:

1. *Is bond cash sufficient to fund all bond projects appropriated by the Legislature, or are some projects on hold due to insufficient bond cash, or other reasons?*

2. *Are cash expenditure projections for bond projects being met? If not, can planned 2012 bond sales be adjusted to reduce the $118 million General Fund cost in 2012-13?*

3. *Going forward, does the Administration support appropriations for unissued bonds, or does the Administration want to curtail any bond programs to preserve General Fund resources?*

Staff Comment: While funding for bond debt service is continuously appropriated, a global discussion on GO bonds may be useful here to understand the Administration's priorities and to help inform future discussion on individual bonds and expenditure plans.

Staff Recommendation: Take no action, this is an informational issue. Direct staff to bring the issue back a future time if the Administration substantially revises their bond plan with the May Revision budget.

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 Overvie w: The January Governor's Budget includes $178.4 million for interest costs on cashflow borrowing and $39 million for interest costs on budgetary borrowing – all General Fund. Of the cashflow amount, $78.4 million is for internal borrowing and $100 million is for external borrowing. Overall, expenditures in this item are up year-over-year – a total of $217.4 million is proposed for 2012-13, versus revised expenditures of $154.4 million in 2011-12. The year-over-year difference is primarily explained by the Administration being conservative and budgeting sufficient funds to cover the uncertainty in interest rates and other factors.

Staff Comment: The budgeted amount for interest costs appears reasonable given the assumptions of the Administration. The assumption that needs review is that related to the repayment of budgetary loans (principal repayment of $486 million in 2012-13) and the associated $39 million in interest. This issue is the discussion issue on the following page.

(see discussion issue on next page)

Issue 1 – Special Fund Loan Repayment Plan (January Governor's Budget)

Governor's Proposal: As indicated in the introduction to this section, the Governor requests $39 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 $486 million. The amount of total special fund loans outstanding as of December 31, 2010, is $3.1 billion, according to the Department of Finance.

Detail: The table on the following page reflects the Administration's planned special-fund loan repayments for the remainder of 2011-12 and for 2012-13. As indicated on the table, the total General Fund cost to repay these loans through June 2013 is $843 million (technically, a $779 million reduction in General Fund revenue to account for the principal repayment and a $64 million General Fund expenditure for interest – over the two fiscal years). The January Governor's Budget scores savings of $631 million from deferring repayment of other loans to 2013-14 and beyond, but the repayment of the $843 million is retained in the proposed budget.

Hearing Questions: The Administration should be prepared to discuss their overall plan for special fund loan repayment for the remainder of 2011-12 and for 2012-13. The Subcommittee may want to hear from the Administration on the following questions:

1. *How did the Administration determine which loans should be repaid and which should be deferred? When a decision was made to repay a certain special fund, how was the repayment amount determined?*

2. *Given significant wall-of-debt progress in other areas of the budget, why does the Administration propose to repay special funds loans in 2011-12 and 2012-13 beyond the level that appears necessary?*

Staff 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. A high-level staff review of the proposed loan repayments and fund condition statement suggests some of loans proposed for repayment could be deferred for additional budget savings in 2012-13 if necessary. The Budget Committee may want to hold final determination on loan repayments until the May Revision when final revenue forecasts are known.

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

Governor's Budget Plan for Loan Repayment in 2011-12 and 2012-13 ($ in thousands)				
Dept	**Fund Name**	**Fund**	**Total Cost to GF**	**Repayment Date**
2011-12 Scheduled Repayments				
DCA	State Dentistry Fund	0741	$2,119	06/30/2012
DCA	Occupational Therapy Fund	3017	$720	06/30/2012
DGS	State Motor Vehicle Insurance Account	0026	$15,053	06/30/2012
HCD	Rental Housing Construction Fund	0938	$573	06/30/2012
DOT	State Highway Account, State Transportation Fund	0042	$219,566	06/01/2012
DOT	Bicycle Transportation Account, State Transportation Fund	0045	$6,587	06/01/2012
DOT	Motor Vehicle Fuel Account	0061	$8,783	06/01/2012
DOT	Environmental Enhancement and Mitigation Program Fund	0183	$4,830	06/01/2012
DOT	Historic Property Maintenance Fund	0365	$3,293	06/01/2012
DOT	Pedestrian Safety Account, State Transportation Fund	2500	$1,883	06/01/2012
CEC	Renewable Resources Trust Fund	0382	$25,211	06/30/2012
DRRR	CA Beverage Container Recycle Fund	0133	$29,100	05/31/2012
SWRCB	Water Rights Fund	3058	$932	06/30/2012
SUBTOTAL FOR REMAINDER OF 2011-12			**$318,650**	
2012-13 Scheduled Repayments				
Technology Agency	State Emergency Telephone Number Acct	0022	$7,030	09/30/2012
Technology Agency	State Emergency Telephone Number Acct	0022	$7,036	12/31/2012
Technology Agency	State Emergency Telephone Number Acct	0022	$7,043	03/31/2013
Technology Agency	State Emergency Telephone Number Acct	0022	$7,049	06/30/2013
DCA	Behavioral Science Examiners Fund	0773	$2,544	06/30/2013
DGS	Public School Planning, Design, and Construction Review Revolving Fund	0328	$11,273	06/30/2013
HCD	Joe Serna, Jr. Farmworker Housing Grant Fund	0927	$1,650	07/01/2012
HCD	Joe Serna, Jr. Farmworker Housing Grant Fund	0927	$1,201	07/01/2012
HCD	Rental Housing Construction Fund	0938	$581	06/30/2013
DOT	State Highway Account, State Transportation Fund	0042	$140,589	06/30/2013
Conservation	Collins-Dugan California Conservation Corps Reimbursement Account	0318	$2,005	07/01/2012
CEC	Renewable Resources Trust Fund	0382	$23,147	06/30/2013
CEC	Renewable Resources Trust Fund	0382	$12,288	06/30/2013
CEC	Renewable Resources Trust Fund	0382	$35,891	07/01/2012
CEC	Alternative and Renewable Fuel and Vehicle Technology Fund	3117	$8,592	06/30/2013
DRRR	CA Beverage Container Recycle Fund	0133	$81,984	06/30/2013
DRRR	CA Beverage Container Recycle Fund	0133	$103,481	06/30/2013
PUC	California Teleconnect Fund Administrative Committee Fund	0493	$71,071	06/30/2013
SUBTOTAL FOR 2012-13			**$524,455**	
GRAND TOTAL FOR REMAINDER OF 2011-12 AND FOR 2012-13			**$843,105**	