SUBCOMMITTEE NO. 4 Agenda

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

Hearing Outcomes

Thursday, February 3, 2011
9:30 a.m. or upon adjournment of session
Room 112

Consultant: Brian Annis

Item Number and Title **Page**

Proposed Vote-Only Issues:

Proposed Discussion / Vote Issues:

(See Table of Contents on page 1 for a more specific listing of issues)

AGENDA – VOTE ONLY ITEMS

AGENDA – DISCUSSION / VOTE ITEMS

Issues Suggested for Vote Only:

California Tax Credit Allocation Committee (0968)

Department Overview: The mission of the California Tax Credit Allocation Committee (CTCAC) is to fairly allocate federal and state tax credits to create and maintain safe quality affordable rental housing for low-income households in California by forming partnerships with developers, investors, and public entities.

Budget Overview: The Governor's Budget proposes total funding of $5.2 million (no General Fund) and 37.0 positions, an increase of $412,000 and an increase of 2 positions.

Issue 1 – Staff Positions for federal requirements (BCP#1)

Governor's Budget Request: The Administration requests $282,000 (special funds) and the establishment of two new Associate Governmental Program Analyst positions and contract funding for federal reporting related to the Housing and Economic Recovery Act of 2008 and the American Recovery and Reinvestment Act (ARRA) of 2009.

Detail: The CTCAC indicates that the workload relates to new reporting requirements instituted by the federal government on June 23, 2010. Specifically, CTCAC must now obtain "tenant specific data" such as race, ethnicity, age, disability status, income, family composition, use of rental assistance under Section 8, and monthly rental payments for each household member in each tax credit unit in each tax credit project in CTCAC's portfolio of over 3,055 tax credit properties which include 266,417 rental units. Additionally, ARRA requires additional asset monitoring activity. CTCAC cites risk of non-compliance and loss of federal funds if the required reporting is not performed.

Staff Recommendation: Approve the budget request.

Action: Approved request on a 3 – 0 vote.

Issues Suggested for Discussion / Vote:

9210 Local Government Financing

Department Overview: The 9210 budget item includes several programs that include State subventions to local governments for such purposes as health, welfare, and public-safety programs. The public safety funding issues are heard in Subcommittee #5 and constitute most of the budget funding in this item. The topics heard in Subcommittee #4 include interest payments on 2009-10 "Prop 1A" borrowing from local governments – about $90.8 million; and a small subvention to Redevelopment Agencies (RDAs) to help retire a portion of outstanding debt that was backed by the personal property tax – about $500,000. Budget issues related to local government finance, such as shifts or borrowing of local property tax, are also heard under this item.

Budget Overview: The proposed budget for the 9210 item is $551 million General Fund, which is similar to the adjusted 2010-11 level. About $455 million of this amount is related to public safety and heard in Subcommittee #5. The remaining $90 million is heard in Subcommittee #4. Prop 1A interest and RDA personal property tax subventions are ongoing, non-controversial, issues. However, the Governor has proposed a significant budget change this year via the elimination of RDA's –that issue is presented for discussion on the following page.

(See budget issue on next page)

Issue 1 – Elimination of Redevelopment Agencies (Governor's Budget)

Governor's Request: The Governor proposes to eliminate redevelopment agencies (RDAs). This elimination would provide a State General Fund solution of $1.7 billion in 2011-12 by shifting a portion of RDA tax increment to offset General Fund costs for trial courts and Medi-Cal. In 2012-13 and thereafter, the non-obligated portion of RDA tax increment – that revenue not needed for outstanding debt and contractual obligations – would flow instead to K-14 schools, cities, counties, and non-enterprise special districts. To facilitate replacement revenue for local economic development, the Governor proposes to lower the vote threshold to 55 percent for specified local tax increases if the revenue is directed to infrastructure.

Background on Redevelopment: Existing law authorizes cities and counties to create a redevelopment project area to address urban blight. Redevelop and "tax-increment financing," which is bonding against future growth in property tax revenue in an RDA area, have existed in California since the 1950s. RDAs are required to set aside 20 percent of their income to help build affordable housing. The RDA share of property tax revenue has grown substantially from 4 percent in 1983-84 to 12 percent currently and the current level of annual increment revenue is about $5 billion. As the RDA share of property tax has increased, the proportion available for schools and other local governments has decreased. The amount lost to the schools is about $2 billion, and because the State backfills the school revenue, this is an annual General Fund cost of about $2 billion.

Detail on the Governor's Proposal: As indicated, the Governor's proposal would eliminate RDAs. However, because RDA's have outstanding debt service and other contractual obligations, the Governor proposes to create successor entities to administer these obligations. The increment revenue necessary for these outstanding obligations would be directed to these successor entities. The Administration estimates these remain obligations, and existing "pass-through" payments to other local governments would total about $3.3 billion in 2011-12. The remaining $1.9 billion of increment revenue would be allocated $1.7 billion to offset State General Fund costs for trial courts and Medi-Cal, and $210 million to cities and counties. In 2012-13 and thereafter, all the non-obligated increment funds would be directed to schools and local governments, with none directed to State General Fund relief. The K-14 funding would be separate from the Proposition 98 funding calculation, and would be net new revenue for schools. Cities, counties, and non-enterprise special districts would receive new revenue to support their public safety and other functions. The Governor proposes that any existing balances reserved for low and moderate income housing be shifted to local housing authorities for those same purposes.

Proposition 22 and Constitutional Issues: In 2009-10 and 2010-11, a total of $2 billion was shifted from RDA's to local schools using a mechanism that provided the State General Fund with expenditure offsets of the same amount. The California Redevelopment Association was opposed to the 2009-10 and 2010-11 shifts, and was a supporter of Proposition 22, which was approved by voters on the November 2, 2010, ballot. Proposition 22 prohibits the Legislature from enacting statute that would redirect RDA funds to benefit the State. The Governor's plan would eliminate RDAs, and in doing so, the Administration believes the proposal is not in conflict with Proposition 22 or other constitutional provisions.

What the Opponents of the Proposal Say: The California Redevelopment Association in a January 10, 2011, press release indicates redevelopment is a vital local government tool in revitalizing blighted communities and bringing them back to economic vitality by creating jobs, funding affordable housing, building public infrastructure improvements, and creating commercial opportunities. Further, if redevelopment were eliminated, it will have a direct and lasting negative impact on the California economy.

What the Administration Says: The Governor's Budget Summary indicates that the private development that occurs in redevelopment project areas often would have occurred even if the RDAs were never established. While (RDAs) may help relieve localized blight and equalize economic activity related to nearby communities, there are better alternatives for local entities to fund these efforts without shifting resources from schools, counties, special districts, and core city services.

Staff Comment: The Legislative Analyst has prepared a summary of the Governor's proposal. The LAO can present this summary at the hearing and highlight what they think are the key issues for consideration. The Department of Finance will also be available at the hearing to explain the legal and implementation details of the proposal.

Staff Recommendation: Hold open for action in the Full Budget Committee. This issue is a major component of the Governor's budget solution, and should be considered in the full context of the Governor's other expenditure and revenue solutions, and any alternative budget solutions that the Full Budget Committee may wish to consider. Additionally, the Senate Governance and Finance Committee will hear this issue on February 9, and that hearing should result in additional analysis and discussion to further inform the decision on this proposal.

Action: Held open to defer action to full budget committee.

9100 Tax Relief

Department Overview: The 9100 budget item includes several programs that provide property tax relief by making payments to local governments to help defray revenues lost as a result of tax relief programs. There are currently two tax relief programs in this item, and the funding amount indicated is the amount of General Fund proposed for 2011-12:

- Homeowners' Property Tax Relief ($442.2 million)
- Subventions for Open Space / Williamson Act ($1,000)

The Homeowners' Property Tax Relief program is constitutionally required, and therefore is fully funded. The Williamson Act program is a discretionary program and funding has either been eliminated or reduced in recent budget years.

Budget Overview: The estimated funding level for Homeowners' Property Tax Relief is unchanged from the adjusted 2010-11 level of $442.2 million. Williamson Act funding is proposed at $1,000 to suspend state payments. It is budgeted at $1,000 instead of $0 due to a technical budget issue and the need to suspend a continuous appropriation that exists in current statute. Governor Schwarzenegger vetoed program funding to $1,000 in the 2009 Budget Act. A trailer bill to the 2010 Budget Act (SB 863) appropriated $10 million for the program, but the proposed budget would also eliminate this 2010-11 funding. Full funding for the Williamson Act would cost about $40 million.

Issue 1 – Williamson Act Open-Space Funding (Trailer Bill Language)

Governor's Request: The Governor proposes to eliminate the Williamson Act Open-Space subvention payment for both 2010-11 and 2011-12 and scores a General Fund (GF) budget savings of $10 million in each year.

Background: The Williamson Act allows cities and counties to enter into contracts with landowners to restrict certain property to only open space and agricultural uses. The land is restricted in use for 10 or 20 years depending on the type of contract. In return for these restrictions, the property owners pay reduced property taxes because the land is assessed at a lower-than-market level. The State then *partially* compensates the local governments for their related property tax loss. In addition to the direct cost of Williamson Act subventions, the State incurs additional costs from backfilling K-14 schools for their reduced property tax receipts under the Proposition 98 minimum guarantee for K-14 education funding. The following table shows recent funding for Williamson Act by fiscal year (dollars in millions)

Fiscal Year	Prop 98 GF Cost*	Williamson Subvention	Total State GF Cost	Comment
2007-08	$40.0	$37.6	$77.6	Fully Funded
2008-09	$40.0	$33.8	$73.8	10% Cut
2009-10	$40.0	$0	$40.0	Suspended
2010-11 (as enacted)	$40.0	$10	$50.0	Modified Funding Program
2010-11 (proposed)	$40.0	*$0*	*$40.0*	*Suspended*
2011-12 (proposed)	$40.0	*$0*	*$40.0*	*Suspended*

* LAO estimate, actual unknown. Prop 98 education backfill continues in the short run even when the Williamson subvention is suspended. Over the longer run, the Prop 98 backfill cost would fall if counties do not renew contracts.

LAO Comment: The LAO has questioned the cost-effectiveness of the subvention program in prior analyses. The LAO indicates the Governor's proposal warrants approval.

Staff Comment: Suspension of funding does not prohibit land owners and counties from continuing to renew Williamson Act contracts. However, some counties have indicated they will not renew contracts if the state does not provide the subvention.

Staff Recommendation: Hold open for consideration in the full Budget Committee.

Action: Held open to defer action to full budget committee.

Commission on State Mandates (8885)

Department Overview: The Commission on State Mandates (Commission) is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. This budget item appropriates the funding for the staff and operations costs of the Commission, and appropriates non-education mandate payments to local governments. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates – in most cases, if the Legislature fails to fund a mandate, the legal requirements are considered suspended pursuant to the Constitution. Payments for mandate costs incurred prior to 2004 are one exception noted in the Constitution, as are mandates related to labor relations.

Budget Overview: The January Governor's Budget proposed expenditures of $56.7 million ($53.7 million General Fund) and 11.0 positions, a decrease of about $27.9 million over the adjusted current-year budget and no change in positions. It should be noted, the 2010-11 adjusted funding level is after the prior Governor's veto of $131 million. The Governor's budget includes the continuation of certain mandate suspensions, some new mandate suspensions, and deferrals of mandate payments to generate General Fund savings of about $321.7 million. The savings measures include: (1) savings of $94.0 million by deferring payment of pre-2004 mandate claims; (2) savings of $172.6 million by suspending certain local mandates; and (3) savings of $55.1 million from deferring payment on expired mandates or some mandates exempt from the requirements of Proposition 1A of 2004. Under (2) above, most mandates are proposed for suspension except those related to law enforcement and tax collection.

Proposed Mandate Funding in Governor's Budget—General Fund

Title	Amount (000s)
Allocation of Property Tax Revenue	596
Crime Victim's Domestic Violence Incident Reports	188
Custody of Minors-Child Abduction and Recovery	13,999
Domestic Violence Arrests and Victim's Assistance	2,565
Domestic Violence Arrest Policies	7,412
Domestic Violence Treatment Services	2,345
Health Benefits for Survivors of Public Safety Officers	1,526
In-Home Support Services II	491
Medical Beneficiary Death Notices	27
Peace Officer Personnel Records	543
Rape Victim Counseling	376
Sexually Violent Predators	21,908
Threats Against Police Officers	40
Unitary Countywide Tax Rates	244
Total	$52,259

Informational Note: Most of the budget proposals in this area are continuations of budget actions taken over the past few years, such as the deferral in payment of pre-2004 mandate claims. Most mandates have been suspended for multiple years to reduce General Fund costs. The mandates that are presented in this agenda are those that are new proposals or involve new issues. The Governor has proposed to fund one mandate – mental health services for students, or the AB 3632 mandate – within the realignment proposal using Proposition 63 funds. The AB 3632 proposal is being considered by Subcommittee #1.

(See budget issue on next page)

Issue 1 – Elections-Related Mandates

Governor's Request: The Governor proposes suspension of the elections-related mandates for the 2011-12 fiscal year. The Administration estimates this action would result in General Fund savings of about $31 million, although this amount may change after February claims are received. Most of the costs associated with these mandates involve postage and administration costs for absentee ballots, although certain voter-registration procedures are also mandates.

Staff Comment: These elections-related mandates have not been suspended in prior years because there has been concern about how suspension would affect the uniformity of statewide elections. If the mandates are suspended and if individual counties choose to modify their elections procedures, voters could see differential treatment depending on their county of residence.

Staff Recommendation: Keep issue open.

Action: Held open to defer action to full budget committee.

Issue 2 –Brown Act / Open Meeting Mandates

Governor's Request: The Governor proposes suspension of the Brown Act mandates for the 2011-12 fiscal year. The Administration estimates this action would result in General Fund savings of about $63 million, although this amount may change after February claims are received. These mandates require local government to post agendas three-days prior to public hearings and to disclose actions taken in closed sessions. One might think this mandate would be inexpensive – with costs such as the cost of paper, but the state is billed for the time local employees spend drafting such agendas, legal review of the documents, etc.

State Constitution Requires Open Government: Proposition 59 of 2004, amended Article I, Section 3 of the California Constitution to state that the people have the right of access to information concerning the conduct of the people's business, and therefore, the meetings of public bodies and the writings of public officials and agencies shall be open to public scrutiny. Voter-approved mandates do not require state reimbursement, but due to difference in specificity between statute and the Constitution, the reimbursement is currently considered required.

Options to Protect Open Meetings, but Save State Costs: Last year, the Budget Conference Committee adopted trailer bill language that would repeal and reenact relevant provisions of the Brown Act to be best practices for compliance with Proposition 59. This action was thought to be a mechanism to relieve the state's reimbursement requirement but still maintain the current open government practices. That provision was stripped from final trailer bill language as the measure moved to a final vote, because opposition came forward with the fear that the statutory revisions would not be sufficient to maintain open-meeting practices. Another option to relieve state costs in the future would be to amend the Constitution to add specificity. For example, Senate Constitution Amendment (SCA) 7 (Yee), would add this sentence to the Constitution: *Each public body shall provide public notice of its meetings and shall publicly disclose any action taken*.

Current Status of the Brown Act: The Department of Finance has stated that the Brown Act is suspended for 2010-11. While the 2010 budget bill did not list the Brown Act as suspended, it also did not list the Brown Act as funded – this was consistent with the original "best-practices" trailer bill approach. Staff is not aware of any local agencies that have changed their open meeting practices due to the current status of the mandate.

Staff Comment: It is clear from budget hearings over the past few years that the Legislature does not want to diminish open meeting requirements. Efforts have focused on retaining these practices while relieving the state cost of reimbursement. Due to ongoing General Fund pressures and a $63 million cost in 2011-12, a Constitutional amendment may be a good solution for consideration.

Staff Recommendation: Keep issue open.

Action: Held open to defer action to full budget committee.

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). 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. However, the $84 million in federal funds would support the program at a new peak level.

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 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 to the General Fund, but adopt TBL to direct that new loan guarantees and renewed loan guarantees use federal funds first – as constrained by any federal rules.
c) Adopt the LAO recommendation to approve 0.5 new staff instead of 1.5 new staff.
d) Reject LAO recommendation to elimination General Fund support for administration, and rather convert program administration funding to 20-percent General Fund and trust fund interest, and 80-percent federal funds, which is proportional to new program resources (trust fund balances should be sufficient to result in no General Fund cost for 2011-12, for a General Fund expenditure savings of about $1.9 million).

Action: Held open to defer action to the February 10 Subcommittee hearing.

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 – 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 ask the three vendor's to propose financing options and held discussion 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 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.

Action: Held open to defer action to the February 10 Subcommittee hearing.

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 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, starting with an initial transfer of $6 million in the current year and $9 million to be transferred once the initial amount is allocated by CAEATFA.

Staff Comment: The Governor's budget requests a $15 million increase in reimbursement and expenditure authority in the current year, and an increase of $9 million 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.

Action: Held open to defer action to the February 10 Subcommittee hearing.

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 $4.9 billion in General Fund costs for GO debt service and related costs. In addition to this amount, $792 million in debt costs are funded from other funds (i.e., $778 million is from the transportation debt fund that is associated with the truck-weight-fee proposal). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide $351 million in 2011-12. The table below, with data from the Governor's Budget, shows the three-year GO bond costs (in millions):

	2009-10 Actual Cost	**2010-11 Estimated Cost**	**2011-12 Estimated Cost**
General Fund cost	$4,639	$4,890	$4,927
Other funds cost	$239	$644	$792
Federal subsidy (Build America Bond Program)	$155	$300	$351
TOTAL Item 9600	**$5,033**	**$5,834**	**$6,070**
Economic Recovery Bonds (not included above)	$1,566	$1,351	$1,407

According to the Governor's Budget, the State has $79.8 billion in outstanding GO bond debt (including self-liquidating bonds). Another $39.6 billion in bonds is authorized, but unissued. The Governor's proposed budget includes $84.6 billion in General Fund expenditure, so GO bond debt service as a percentage of General Fund expenditures is 5.8 percent (or 7.5 percent when ERBs are included).

(see budget issue on next page)

Issue #1 - Deferral of Spring 2011 Bond Sale (Governor's Proposal)

Governor's Proposal: The Administration proposes to defer the spring 2011 bond sale until the fall, which would result in General Fund debt-service savings of approximately $248 million in 2011-12. During budget hearings last spring, the Schwarzenegger Administration had assumed a spring 2011 bond sale of $6.7 billion, but that number had been revised down to $3.5 billion in the Administration's fall estimate. This is not scored as a General Fund solution in the budget, because the assumption was built into the workload budget. The Administration now assumes $5.8 billion in bond sales this fall.

Detail: There has been some uncertainty among the various bond stakeholders about what the sales deferral means for individual bond programs. The Governor's budget explicitly cites a policy change to decrease Proposition 1C Housing bonds by $99 million in 2011-12 to reflect a one-time pause in new loans and grants for housing projects. Aside from the Proposition 1C statement, the Administration has told Committee staff that the remainder of bond programs should proceed as previously expected with cash balances from prior bond sales. Specifically, a cash balance of $13.3 billion from prior bond sales was on hand in December 2010, and that amount is expected to fund all underway bond projects through December 2011, and fund new project allocation that are planned to occur through June 2011 (including cash for those new projects also through December 2011). For projects expecting an allocation after June 2011, and for ongoing project cash needs after December 2011, the state would need to sell additional bonds this fall. The below table shows cash on hand by bond for some of the major bond acts (dollars in millions).

Bond Program	**Cash, or bond proceeds, as of Dec 2010**
Prop 1B of 2006: Transportation	$3,112
Prop 1E of 2006: Disaster Prep and Flood Prevention	$1,709
Prop 84 of 2006: Safe Drinking Water	$1,565
Prop 46 of 2002 &Prop 1C of 2006: Housing	$1,339
Prop 47 of 2002 & Prop 55 of 2004: Education Facilities	$1,249
Prop 71 of 2004: Stem Cell Research	$361
Prop 3 of 2008: Children's Hospital Bond Act	$341
Prop 1A of 2008: High Speed Rail	$245
All others	$3,406
TOTAL	**$13,327**

Staff Comment: The Administration should outline their plan for bond sales and how it will affect infrastructure projects under construction, and near construction.

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

Action: Information issue, no action taken.

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 measure 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.

Action: Held open to defer action to the February 10 Subcommittee hearing.

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

Governor's Proposal: As indicated in the introduction to this issue, the Governor 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.

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

Action: Informational issue not heard, defer discussion to February 10 Subcommittee hearing.