

SUBCOMMITTEE NO. 4

Agenda

Senator Maria Elena Durazo
Senator Jim Nielsen
Senator Thomas J. Umberg



Thursday, April 25, 2019
9:30 a.m. or upon adjournment of session
State Capitol - Room 2040

Consultants: Anita Lee, Yong Salas

ITEMS PROPOSED FOR VOTE ONLY

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Public Comment

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ITEMS PROPOSED FOR VOTE-ONLY**CALIFORNIA ACHIEVING A BETTER LIFE EXPERIENCE PROGRAM****Issue 1: Continued Implementation and Administration of the CA Achieving a Better Life Experience Program (CalABLE)**

Governor's Budget. The Governor's budget requests a General Fund loan of \$1.1 million in 2019-20 to provide the following resources: 1) \$820,000 to continue to support administrative costs and implementation of the CalABLE program, including funding for staff, funding for external consultants and funding necessary for operating and overhead costs; and 2) \$250,000 to support the marketing and outreach activities of the program post-launch, increasing awareness and participation in the program.

Background. On December 19, 2014, President Obama Signed the Stephen Beck Jr., Achieving a Better Life Experience Act of 2014 (ABLE), which allows individuals who become blind or disabled before reaching age 26 to create tax-free savings accounts. ABLE accounts generally follow the same rules as 529s: individuals can make nondeductible cash contributions to an ABLE account in the name of a specified beneficiary, and with tax-free earnings. ABLE account distributions are also not included in the beneficiary's income, as long as they are used for qualified services for the beneficiary and distributions do not exceed the cost of those services.

SB 324 (Pavley), Chapter 796, Statutes of 2015, established the CalABLE Board for the purpose of developing, implementing and administering the CalABLE Act Program. AB 449 (Irwin), Chapter 774, Statutes of 2015, established the ABLE program trust for purposes of implementing the federal ABLE Act. The bill authorized the ABLE Act Board to adopt regulations to implement the program. It further created the program fund, a continuously appropriated fund, thereby making an appropriation, and the administrative fund, as specified. The bill required the Board to administer the program in compliance with the requirements of the federal ABLE Act. The Program is still in the implementation stage having launched publicly on December 17, 2018.

With the Board's initial and subsequent appropriations slated to be expended at the end of this fiscal year, the Board requests a new appropriation of \$1.1 million, in the form of a General Fund Loan, to continue to support the Board's ongoing administrative costs and program implementation and administration. This amount is consistent with prior allocations approved by the Legislature and would maintain current staffing levels and operational expenses.

Staff Recommendation. Approve as budgeted.

ITEMS PROPOSED FOR DISCUSSION

2100 DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

Overview. The Department of Alcoholic Beverage Control (ABC) licenses and regulates approximately 93,000 licenses engaged in the manufacture, importation, distribution, and sale of alcoholic beverages in California. The department's mission is to administer the provisions of the Alcoholic Beverage Control Act in a manner that fosters and protects the health, safety, welfare, and economic well-being of the people of California.

Issue 2: Business Modernization and Responsible Beverage Service

Budget. The Department of Alcoholic Beverage Control (ABC) requests \$2.9 million (\$2,922,000) in 2019-20 for 5.5 positions and trailer bill language to provide capacity and resources to fulfill the requirements for the Responsible Beverage Server (RBS) Training Program Act pursuant to AB 1221, Gonzalez Fletcher, Chapter 487, Statutes of 2017, and to provide eServices for ABC licensees.

Background. AB 1221 (Chapter 487, Statutes of 2017) established the RBS Training Program Act, and required ABC to develop, implement, and administer a curriculum for an RBS training program, and also required alcohol servers to obtain alcohol server certification. RBS is a type of training that is offered to promote public safety and to reduce risks associated with the retail alcohol environment, and are offered by both public and private organizations. Currently, some cities and counties currently require RBS training to sell or serve alcoholic beverages at establishments within those jurisdictions. At the time, the Senate Appropriations Committee estimated that ABC would have one-time costs of approximately \$294,000 with ongoing costs of approximately \$232,000 to promulgate regulations and to implement the legislation.

ABC recently underwent an internal Information Technology (IT) governance process review and identified electronic payment as the top priority to improve its public-facing services, among other priorities. The existing system, the Alcoholic Beverage Information System (ABIS), which manages ABC licenses, was launched in May 2010 and does not have the capability to provide the option of electronic payment or support online applications. At the same time, ABC has determined that its IT Branch does not have the capability or capacity to develop applications to implement certain aspects of the RBS Training Program, such as certification requirements of alcohol servers, within their existing IT infrastructure. As a result, ABC decided to combine these projects since they both have shared project resources and functions that are dependent on each other, and will allow the department to manage the vendors and contracts more efficiently. The Department of Finance states that the Business Modernization and Responsible Beverage Service project is expected to complete Stage 4 of the Project Approval Lifecycle (PAL) Process, which is the Department of Technology's approval process for IT projects, on September 30, 2019.

This request will provide one-time funding for the first year of external consulting services to develop and implement the new application, credit card fees for electronic payment, as well as one position to support the RBS training program and 4.5 positions for IT. ABC indicates that it will submit another budget request for 2020-21 and beyond when the department can better estimate the operational costs.

Trailer bill language. ABC requests trailer bill language to “clarify the Department’s ability to collect an examination fee.” The proposed language is as follows:

Amend Business and Professions Code Section 25685 as follows:

~~25685. (a) The department may charge a fee, not to exceed fifteen dollars (\$15) per person, for any RBS training course provided by the department. Any moneys collected under this article shall be deposited in the Alcohol Beverage Control Fund.~~

~~(b) The department may adopt rules that it determines necessary for the administration of the provisions of this article.~~

(b) The department may charge fees as necessary to cover its reasonable costs for administering the program authorized by this article.

(c) If the department offers a RBS training course, the fee charged by the department for that course shall not exceed fifteen dollars (\$15) per person.

(d) Any moneys collected under this article shall be deposited in the Alcohol Beverage Control Fund.

ABC states that in order to cover costs to administer the RBS program, it will need to charge prospective servers \$3.24 to take the certification exam.

Legislative Analyst’s Office (LAO). The LAO states this project has not yet completed the Project Approval Lifecycle (PAL) process. Accordingly, the Legislature is being asked to approve funding without the benefit of a complete project plan. The LAO recommends that the Legislature consider approving the funding request with budget bill language that conditions the funding on prior written notification of, and approval by, the Legislature once PAL documents have been approved.

Staff Comment. Staff does not have concerns with the proposal to modernize its IT capabilities to include electronic payment or online applications, while also implementing the RBS program. However, the proposed trailer bill language would allow the department to charge prospective alcohol servers a fee to cover the administration costs of the program. Staff recommends that the subcommittee consider adopting language that places a cap on what the department can charge RBS training participants as a fee.

Staff Recommendation. Hold open.

Issue 3: Program Performance Improvement Initiative

Budget. ABC requests 34 positions and \$5.2 million (\$5,249,000) in funding from the Alcohol Beverage Control Fund in 2019-20 and increases to a total of 51 positions and \$7.5 million (\$7,469,000) in 2022-23. This proposal also includes trailer bill language to adjust fees to address the existing annual operating deficit and the additional revenue required to support proposed program performance improvements.

Background. ABC is a special funded department, with approximately 95 percent of ABC's operating budget appropriated from the Alcohol Beverage Control Fund, and five percent comprised of reimbursements. ABC revenues come from several categories of fees charged to licensees:

- Original license fees, which are charged for the issuance of a new license.
- Annual renewal fees, which are charged for the annual renewal of existing licenses.
- Daily fees, which are charged for one-day events, such as festivals and fundraisers.
- Transfer fees, which are charged when a business transfers ownership or the location of a license.
- Other revenue sources, such as penalty fees for late renewal payments, business practices fees, and caterer permits. (Penalties from settlements from enforcement actions are deposited into the General Fund.)

ABC states that though its expenditures has long exceeded its revenues, its budget has shown a fund balance which has masked this imbalance, due to: (1) its high rate of vacancies; and (2) recession-era reductions in expenditures, including the furlough program. However, over the last three years, increased spending from reducing the vacancy rate for sworn personnel and recent pay increases for all employees has reduced the fund balance significantly. ABC states that the difference between ABC's revenues and expenditures was \$9 million in 2017-18, and is projected to be \$10.5 million in 2018-19. Without action to align revenues and expenditures in 2019-20, ABC states that the Alcohol Beverage Control Fund would be exhausted during the 2019-20 fiscal year.

Since 1978, ABC had not adjusted its fees until legislation was enacted in 2001 to authorize fee adjustments. Since then, the Department has periodically submitted fee adjustments. The following provides fee adjustments that were made by the department to meet operational costs:

- ***Phased-in fees adjusted in 2002, 2003, and 2004.*** AB 1298 (Wesson and Oropeza), Chapter 488, Statutes of 2001, authorized fee adjustments that resulted in increases to various renewal fees, with percentages ranging from 17.41 percent to 120.83 differing by license type and fee, and these fee adjustments were phased in to lessen the impact of the increase, and required future fee adjustments to be submitted to the Legislature for approval.
- ***Fees adjusted in 2009 and 2010.*** AB 1389 (Committee on Budget), Chapter 751, Statutes of 2008, authorized fee adjustments by an increase of 11.78 percent in 2009, with a second fee adjustment by inflation of 3.49 percent in 2010.

- ***Fees adjusted in 2018.*** The 2017-18 Budget Act increased fees by 11.48 percent, which was expected to increase revenue by \$5 million, closing half of the \$10 million deficit that was projected at the time.
- ***Fees adjusted in 2019.*** The 2018-19 Budget Act increased fees by 2.93 percent.

While previous fee adjustments were made as part of the budget process and required legislative approval, this proposal would allow ABC to submit a notification to the Joint Legislative Budget Committee (JLBC) 90 days prior to when the adjusted fees would take into effect.

This proposal will address three main challenges: (1) increasing the enforcement and licensing capacity so that issuing licenses or enforcement actions can be taken in a timely manner; (2) shoring up expertise and consistency in the licensing program, whose workload is currently being shifted from sworn personnel to non-sworn personnel; and (3) modernizing services to the public, such as online licensing applications, online renewal, and electronic payments. ABC states that though their staffing levels have been relatively maintained since 1955, the number of permanent licensees have doubled. ABC was authorized for 445 positions in 1954, and are presently authorized for 459 positions.

The fee restructuring and increase will go towards “right-sizing” the Department’s operational budget, and fund additional staff to meet the workload of its licensees. The increase in positions are comprised of the following (beginning on the next page):

Proposed Workload

	2019-20 Positions	2019-20 Funding	2020-21 Positions	2020-21 Funding	2021-22 Positions	2021-22 Funding	2022-23 Positions	2022-23 Funding	Comments
Enforcement Staff	5	988,000	10	1,784,000	10	1,594,000	10	1,594,000	Increase the number of premises visited for compliance checks, propose educational outreach to new licensees, focus on reducing the rate at which licensees sell to minors, trail local law enforcement agencies, improve internal training to agents, increase resources directed at industry complaints of unfair competition, and develop a more flexible and responsive workforce.
Legal Support for Enforcement Program	3	565,000	3	538,000	3	538,000	3	538,000	Meet increasing prosecutorial workload.
Bifurcation	1	238,000	4	685,000	10	1,592,000	13	2,016,000	Complete 25-year process to shift licensing duties to non-sworn personnel.
Centralization of non-retail licensing duties	7	898,000	7	835,000	7	835,000	7	835,000	Create a centralized licensing unit for non-retail license applications, and re-direct district office workloads associated with applications that generally require extensive research and specialized knowledge.
Licensing Training Unit	3	376,000	3	349,000	3	349,000	3	349,000	Create a licensing training unit to provide consistency to the public and to internal operations.

<i>Cont'd.</i>	2019-20 Positions	2019-20 Funding	2020-21 Positions	2020-21 Funding	2021-22 Positions	2021-22 Funding	2022-23 Positions	2022-23 Funding	Comments
Legal Support for Licensing Unit	2	339,000	2	321,000	2	321,000	2	321,000	Provide legal support statewide to review licensing matters, assist with policy development, and support training for licensing staff.
Law and Regulatory Policy Unit	3	459,000	3	432,000	3	432,000	3	432,000	Creates the Law and Regulatory Policy Unit to address backlog of issues requiring regulatory clarification.
Communications	1	154,000	1	145,000	1	145,000	1	145,000	Modernize its communications program.
Information Technology	8	1,105,000	8	1,121,000	8	1,121,000	8	1,121,000	"Right-size" the IT Branch to address the existing functional gaps and increases the capacity of the IT Branch.
Accounting	1	127,000	1	118,000	1	118,000	1	118,000	Address accounting challenges.
TOTAL	34	5,249,000	42	6,328,000	48	7,045,000	51	7,469,000	

In order to fund its workload and to stabilize its revenue source, ABC proposes to restructure and increase its fees related to new applications, annual renewals, and various business practices, which is projected to generate approximately \$19.5 million annually. Additionally, ABC will be authorized to increase these fees by inflation with 2019, as the base year upon notification to the Joint Legislative Budget Committee, on the condition that the fund balance dips below a three-month reserve.

Below are the proposed fee increases for new applications:

Program Performance Improvement Initiative
Proposed Changes to Application Fees

Attachment A -2

Licensing Transaction Category	Current Fee	Proposed Fee	Proposed Increase in Revenue
Original			
Original \$50	\$50	\$905	\$5,130
Original \$100 Full Investigation	\$100	\$905	\$1,189,790
Original \$100 Limited Investigation	\$100	\$100	\$0
Original \$200	\$200	\$905	\$21,150
Original \$300	\$300	\$905	\$1,161,600
Original \$500	\$500	\$905	\$0
Original General - non CPI	\$12,000	\$12,000	\$0
Original General \$1000	\$1,000	\$1,000	\$0
Original General \$2000	\$2,000	\$2,000	\$0
Original General \$6000	\$6,000	\$6,000	\$0
Original General CPI	\$15,835	\$15,835	\$0
Total			\$2,377,670
Daily/Event			
Daily Beer	\$25	\$	(103,325)
Daily Wine	\$25	\$	(141,000)
Daily Beer and Wine	\$50	\$50	\$488,650
Daily On-Sale General	\$25	\$75	\$1,180,450
Special Daily License	\$100	\$100	\$0
Catering Authorization	\$25	\$	(523,575)
Event Permit	\$25	\$	(24,725)
Catering or Event attendance under 1,000	\$25	\$100	\$2,083,200
Catering or Event attendance 1,000-5,000	\$25	\$325	\$243,750
Catering or Event attendance 5,000+	\$25	\$1,000	\$350,000
Invitation-only events	\$200	\$200	\$0
Beer and Distilled Spirits Tasting	\$100	\$100	\$0
Total			\$3,553,425
Transfer			
Exchange	\$100	\$100	\$0
Fiduciary Transfer	\$50	\$100	\$21,758
Intercounty Transfer	\$6,000	\$6,000	\$0
Multiple Merge Transfer	\$100	\$100	\$0
Premises to Premises Transfer	\$100	\$780	\$516,140
Person to Person Transfer non-general ¹	various	\$335	\$523,861
Person to Person Transfer General	\$1,250	\$1,250	-\$451,250
Double Transfer non-general ¹	various	\$905	\$97,740
Double Transfer general	\$1,350	\$1,250	\$451,250
Adding a Family Member Transfer ²	various	various	\$0
Stock Transfer - General	\$800	\$800	\$0
Total			\$1,159,499
Temp/Interim			
Interim Permit	\$100	\$145	\$7,200
Temporary License	\$100	\$100	\$0
Total			\$7,200

Update/Change			
Condition Modification	\$100	\$475	\$90,375
Corporate Updates (new fee)		\$300	\$225,000
Drop Partner	\$50	\$115	\$13,577
Manager Qualifications	\$100	\$140	\$18,958
Premises Expansion (new fee)		\$380	\$95,760
Premises Reduction (new fee)		\$345	\$15,525
Total			\$459,196
Beer Kegs			
Beer Keg Receipt Book	\$9	\$10	\$2,019
Beer Keg Tags	\$21	\$25	\$5,281
Total			\$7,300
Miscellaneous			
Private Warehouse	\$50	\$170	\$7,080
Replacement	\$6	\$25	\$11,778
Rule 65 Reactivation (new fee)		\$75	\$1,200
Increase due to non-refundable application fee		\$905	\$473,315
Total			\$493,373
Grand Total			\$8,057,662
1- The various application fees of a person to person transfer non- general and double transfer non-general are equal to 70 percent of the annual fee for non-retail licenses and 50 percent of the original fee for the retail licenses.			
2- The fee for transfer of an on-sale or off-sale retail license to include a family member, is one half of the regular fee for person to person transfer, not to exceed \$625.			

As noted in the chart above, ABC is proposing to increase new application fees, which are currently set between \$50 and \$500, to a flat \$905 fee. The Department is also proposing new fees to generate revenue, including:

- Non-refundable application fee.*** ABC states that application fees, which helped cover workload costs related to assessing applications, are currently refunded upon the withdrawal of the application despite significant work being conducted by the Department. This change would allow the Department to cover workload costs, and is estimated to generate approximately \$473,000. However, annual fees will be refundable as ABC collects the application fee and the annual fee at the same time, and the Department states that it would not need to retain the annual fee for a prospective licensee if the license does not get issued.
- Corporate Update fee.*** A corporation, limited partnership, and limited liability company holding licenses are required to report any changes in ownership, management, control of the organization to the Department, who then determines if a license transfer occurred. The proposal would impose a \$300 fee to submit this report, which currently is free to submit to ABC and would be credited towards the license transfer fee if it applies. The Department estimates that this will generate \$225,000. Limited liability companies and corporations are also required to update their business file every two years or whenever there is a change to the organizational structure with the Secretary of State, and the fee to do so is \$25. ABC states that the new \$300 fee would include background checks of new officers, stockholders, managers, and members to ensure they meet the qualifications of a licensee, and research into possible tied-house ownership issues.

- **Premise expansion/reduction fee.** The proposal would charge licensees a fee to make “material or substantial physical changes” to its premises only upon the application to and approval by the department. ABC states that premises modifications require a site visit from ABC staff to determine if the expanded area will bring the premises closer to nearby residents or other considerations, such as schools. These fees would range from \$345 to \$380, and are projected to generate approximately \$112,000 annually.

The Department is also proposing to adjust its various annual renewal fees, and these adjustments are estimated to generate approximately \$11.4 million in revenue.

Enforcement. The mission of the Department is to administer the provisions of the Alcoholic Beverage Control Act through licensing, education, and enforcement. When ABC conducts its enforcement operations, individuals who are accused of violating the law have either administrative complaints filed against them with ABC or criminal cases filed with the local district attorney’s office, depending on the nature and the individual committing the violation. The table below illustrates the volume of the administrative and criminal cases, which the Department states are not always mutually exclusive. For example, a clerk at a store selling to a minor would produce an administrative case against the licensee and a criminal case against the clerk. Violation of underage drinking laws may vary from infractions to misdemeanors, and are punishable with fines and community service.

Fiscal Year	Administrative Cases Filed with ABC	Criminal Cases Filed with District Attorney’s Office
2017-18	1,366	3,277
2016-17	1,243	4,011
2015-16	1,638	3,968
2014-15	1,865	3,359
2013-14	1,876	3,646

The Department states that the number of criminal cases exceeds the number of administrative cases for several reasons:

- During major events such as concerts, fairs, and festivals, agents can issue several citations for ‘minor in possession of alcohol’ in the parking lots or outside surrounding area, and often make more than 100 arrests at these events. Since violations do not occur on the licensed premises, and there is no nexus to ABC licensee or their employees, an administrative accusation is not filed against the ABC license.
- Agents also respond to community complaints concerning underage drinking activity occurring at unlicensed locations (high school events, pledge week events near college campuses, etc.).

There is no ABC license in connection with this illegal activity, so misdemeanor violations do not result in ABC administrative action.

- Agents could issue multiple citations at a licensed business, but the administrative actions would result in one administrative case. For example, agents can issue citations to four minors and one bartender, but it would result in one administrative case consisting of four counts for serving alcohol to minors.
- Operation Shoulder Tap, an enforcement program administered by the Department to deter youth access to alcohol and to raise public awareness that furnishing alcoholic beverages to a minor is illegal, occurs outside of liquor stores and the focus is not designed to take administrative action against the ABC licensee. This operation consists of a minor decoy working under the direction of law enforcement, and randomly asking adults if they would purchase alcohol for them after stating their true age.
- Counterfeit identification is prevalent in college communities and minors often use fake driver licenses in attempt to enter a night club or purchase alcoholic beverages. Agents will detain the minor in these situations and issue citations for possessing false identification. These situations do not result in an administrative case.

Agents within the enforcement unit are sworn peace officers, and the chart below provides a resource history of the enforcement program within ABC:

Resource History (Dollars in thousands)					
Program Budget	2013-14	2014-15	2015-16	2016-17	2017-18
Authorized Expenditures	14,845	17,876	18,250	18,683	20,734
Actual Expenditures	14,481	14,944	16,665	21,079	21,132
Revenues	0	0	0	0	0
Authorized Positions	133	145	146	144	142
Filled Positions	115	116	125	129	135
Vacancies	18	29	21	15	7

ABC requests five agents in 2019-20 and \$988,000, increasing to 10 agents and \$1.8 million in 2020-21, with \$1.6 million ongoing thereafter. This request will allow the enforcement unit to: (1) increase the number of premises and events visited; (2) increase operations targeting youth access to alcohol, including on-view operations, doubling decoy operations by 2020-21, and increasing licensee training; (3) increase outreach to local law enforcement agencies; (4) increase non-retail training for ABC agents; and (5) implement a pilot program for new licensees whose licenses were issued over the protest of the public or local government. The projected workload for this request is as follows:

Projected Outcomes						
Workload Measure	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
ABC's current backlog of complaints	2,000	1,700	1,400	1,300	1,000	700
Enforcement premises visited	38,500	39,000	40,700	40,700	40,700	40,700
Decoy operations	150	150	306	306	306	306
Visiting protested licensees (new)	0	0	300	300	300	300
Roll Call/TRACE trainings	90	90	140	140	140	140
IMPACT inspections	2,000	2,000	2,400	2,400	2,400	2,400
Trade enforcement Investigations by district Agents	4	4	100	100	100	100
Trade enforcement trainings	0	10	30	30	30	30

Local Activities. Part of the enforcement activities would implement a pilot program for protested licenses that were issued despite concerns from the public or the local government with the goal of strengthening the partnership between ABC and the licensee to avoid the concerns raised by those who were protesting.

Staff Comment. Staff notes that the proposal would change the fee adjustment process from requiring legislative approval through the budget process to notification to the JLBC. The proposal would only allow a fee adjustment by inflation to occur when the Department's reserves dip below a three-month level, and use January 2019 as the base year for which these adjustments are made, and rounded to the nearest \$5 dollars. However this could allow a fee adjustment of 10%+ in one given year after a period of time when no such adjustments were made. The subcommittee may wish to consider that it require legislative approval for any future fee adjustments that may occur.

Staff Recommendation. Hold open.

7920 CALIFORNIA STATE TEACHERS RETIREMENT SYSTEM (CALSTRS)

CalSTRS is governed by the Teachers' Retirement Board, which is composed of eight members and four ex-officio members. The California Constitution provides the Teachers' Retirement Board authority over the administration of the retirement system. CalSTRS provides pension benefits, including disability and survivor benefits, to California's full-time and part-time public school teachers from pre-kindergarten through community college and certain other employees of the public school system. As of June 30, 2018, there are approximately one million members, retirees, and beneficiaries of the State Teachers' Retirement Plan (STRP) Defined Benefit Program.

CalSTRS administers a defined benefit plan, two defined contribution plans, a post-employment benefit plan, and a fund used to account for ancillary activities associated with various deferred compensation plans and programs, including: (1) STRP, (2) CalSTRS Pension Program, (3) Teachers' Health Benefits Fund, and (4) Teachers' Deferred Compensation Fund.

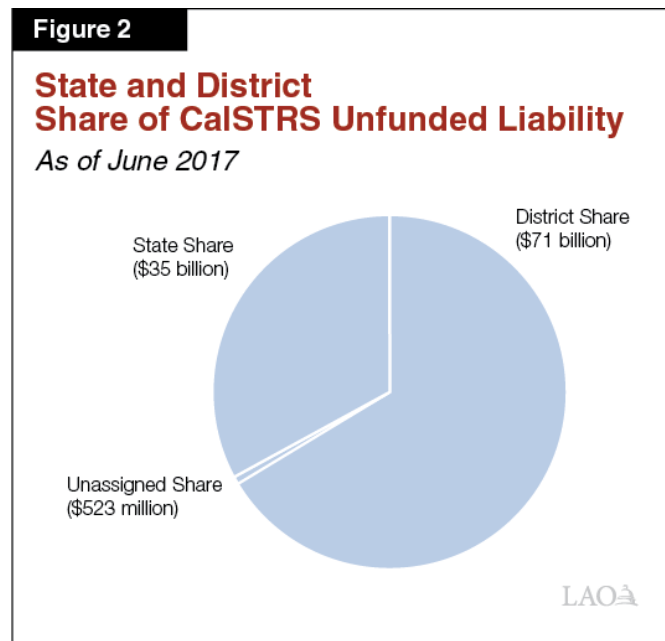
CalSTRS does not provide health or dental insurance coverage as they are collectively bargained at the local school district level. Each district has its own policies. Existing law requires school districts, community colleges and county offices of education to offer retiring CalSTRS members and their spouses or registered domestic partners the opportunity to continue their medical and dental insurance at their own cost.

CalSTRS Budgeted Expenditures and Positions
(Dollars in Millions)

	2017-18	2018-19	2019-20
Service to Members and Employers	\$382.0	\$604.8	\$571.6
Corporate Governance	\$4.8	\$36.2	\$34.7
Benefit Payments	\$14,462.5	\$15,822.7	\$16,759.1
Positions	1,134	1,294	1,313

Issue 4: Supplemental Pension Payment**Background**

Prior to 2014, CalSTRS faced a large unfunded liability with no plan in place to fund teachers pensions, and CalSTRS was expected to exhaust its assets in the mid-2040s. The state adopted a funding plan, described below, to fully fund the system by 2046. Currently, the overall unfunded liability for CalSTRS is \$107.3 billion (of which the state's share is \$35.3 billion). As of June 30, 2017, the funded status for CalSTRS was 64 percent meaning the retirement systems only have approximately two-thirds of the funds required to make pension payments to retirees.



Assembly Bill 1469 (Bonta), Chapter 47, Statute of 2014, CalSTRS Funding Plan to Address Large Unfunded Liability. AB 1469 was adopted as a part of the 2014-15 budget, which set CalSTRS on a path towards full funding by 2046. Specifically, the plan phased in contribution rate increases for the state, employers and employees. The plan gives the board limited authority to adjust the employer and state contribution rates.

- **District Contribution Rate.** AB 1469 set the district contribution rate through 2020-21, which increases the rate from 14.4 percent of salary in 2017-18 to 16.3 percent in 2018-19. This is an increase of 1.9 percentage points. By 2020-21, the district rate is set to reach 19.1 percent. After 2020-21, CalSTRS can increase or decrease the rate by up to one percentage point per year; however, existing law states that the total district rate cannot exceed 20.25 percent.
- **Employee Contribution Rate.** The Public Employees' Pension Reform Act (PEPRA) requires employees hired after January 1, 2013, to pay half of the normal cost of their pension benefits. Due primarily to the assumption of lower investment returns, CalSTRS' estimate of the normal cost has increased. As a result, the contribution rate for PEPRA employees is increasing from 9.2 percent in 2017-18 to 10.2 percent in 2018-19.

Absent future changes in the investment return and other assumptions, PEPRA employees' contribution rates will tend to remain more stable than the district and state rates. Compared to PEPRA employees, existing law specifies the rate for employees hired prior to January 1, 2013, to remain flat at 10.3 percent, rather than being tied to an estimate of normal cost.

- **State Contribution Rate.** The state's share of the unfunded liability has more than doubled in recent years, growing from \$15 billion as of June 30, 2015 to over \$35 billion as of June 30, 2017. Existing law limits the annual allowable increase in the state rate to 0.5 percentage point. The CalSTRS board approved a 0.5 percentage point increase in the state contribution rate for 2018-19, bringing the total state rate to 9.6 percent. Because of the rate adjustment limit in state law, CalSTRS projects that the state rate will continue increasing by 0.5 percentage point each year through 2023-24.

The Legislative Analyst's Office (LAO) chart below displays the projected CalSTRS contribution rates.

CalSTRS Projected Contribution Rates
(As a Percentage of Payroll, May 2018 Projections)

Year	District ^a	State ^b	Employees (Pre-PEPRA) ^c	Employees (PEPRA) ^d
2017-18	14.4%	9.1%	10.3%	9.2%
2018-19	16.3%	9.6%	10.3%	10.2%
2019-20	18.1%	10.1	10.3%	10.2%
2020-21	19.1%	10.6%	10.3%	10.2%
2021-22	18.6%	11.1%	10.3%	10.2%
2022-23	18.1%	11.6%	10.3%	10.2%

^a Reflects statutory rate through 2020-21 and CalSTRS' projections thereafter.

^b Reflects actual rate through 2018-19 and CalSTRS' projections thereafter. State contribution rate is based on payroll from the second preceding year. For example, the 2018-19 rate is applied to actual 2016-17 payroll. Includes roughly 2.5 percentage points related to a program that protects retirees' pensions from the effects of inflation.

^c Reflects fixed statutory contribution rate for employees hired before January 1, 2013.

^d Reflects actual rate through 2018-19 and CalSTRS' projections thereafter.

CalSTRS Unfunded Liability. The state is responsible for the share of the unfunded liability that would exist today if no changes had been made to benefits or contributions since 1990, and districts are responsible for the unfunded liability created by changes to pension benefits and contribution rates adopted after 1990, but only for benefits earned through 2013-14.

CalSTRS interprets the law so that district and state shares of the unfunded liability will change annually based on a complex formula. Specifically, the formula is based on hypothetical unfunded liability calculated by estimating what the defined benefit program's assets and liabilities would be today if the benefit improvements had never occurred after July 1, 1990, and if contributions to the pension fund had not been decreased. Under this formula, the calculations show that CalSTRS' unfunded liability would be smaller today. In general, the state will pay for these smaller theoretical unfunded liabilities, while the districts pay for the difference between the real world unfunded liabilities and the state's share. Because districts pay for the balance, the district share will increase when the state share decreases or

vice versa. As a result, the state's share of the unfunded liability and the contribution rate is very sensitive to investment volatility.

Responsibility for a small amount of the unfunded liability that is associated with changes made after 1990 for benefits earned after 2013-14 remains unassigned to either the state or districts. As of June 2017, the LAO estimates that the unassigned share is \$523 million. The funding formula does not include a mechanism for funding this unassigned unfunded liability.

Discount Rate. In February 2017, the CalSTRS board adopted changes to investment return assumptions over a two-year period. Specifically, for the June 30, 2016 actuarial valuation, the discount rate decreased from 7.50 to 7.25 percent, and for the June 30, 2017 actuarial valuation, the discount rate decreased from 7.25 to 7 percent.

Reporting Requirement. AB 1469 also requires CalSTRS to report to the Legislature on or before July 1, 2019, and every five years thereafter, on the fiscal health of the Defined Benefit Program and the unfunded actuarial obligation with respect to service credited to members of the program, before July 1, 2014. The report must identify adjustments required in contribution rates in order to eliminate, by June 30, 2046, the unfunded actuarial obligation of the Defined Benefit Program with respect to service credited to members of the program before July 1, 2014.

Governor's Budget Proposal

District's Share of Unfunded Pension Liabilities. The Governor proposes for the state to pay CalSTRS an additional \$2.3 billion General Fund in 2018-19 to address the district's share of the unfunded liability.

CalSTRS District Contribution Rates. The Governor proposes providing \$700 million over the next two years (\$350 million per year) to provide school and community college districts with immediate budget relief. Specifically, the funds would reduce districts' CalSTRS rates in 2019-20 and 2020-21—freeing up resources for other parts of districts' operating budgets.

Restructures Proposition 2 Plan to Pay Down State's Share of CalSTRS Unfunded Liability. Proposition 2, the Rainy Day Budget Stabilization Fund Account (Assembly Constitutional Amendment 1 in the November 2014 ballot), requires specified state revenues to be dedicated to the Budget Stabilization Account (BSA) and partially used to repay state debts and unfunded liabilities. By paying down all remaining special fund loans with discretionary resources, the Administration creates capacity within Proposition 2 requirements for other debt payments. The Governor proposes using this new capacity to reduce the state's share of the CalSTRS unfunded liability.

The Governor proposes to pay \$1.1 billion in Proposition 2 to CalSTRS in 2019-20 to address the state's share of the unfunded liability. Moreover, the Administration proposes an additional \$1.8 billion in Proposition 2 funds through 2022-23, as follows: \$802 million in 2020-21, \$615 million in 2021-22, and \$345 million in 2022-23, to be paid towards the state's share of the unfunded liability.

The Governor's proposed trailer bill language provides the Department of Finance the authority to determine the schedule and timing of the transfer of funds.

Estimated Savings from the Proposed Supplemental Payment for the Employer Liability Share to CalSTRS. The Administration estimates that the proposed \$3 billion General Fund (\$2.3 billion to address the employer share of the CalSTRS unfunded liability, and \$700 million to supplant the required contributions for school employers for 2019-20 and 2020-21) payment in 2018-19 would save school employers \$6.9 billion (\$3.9 net savings) over the next 30 years under current actuarial assumptions.

The Administration estimates that the \$700 million to supplant the school employer contributions would result in a one percent reduction in the employer contribution for 2019-20 and 2020-21. Moreover, the \$2.3 billion supplemental payment to the employer share of the unfunded liability would reduce the employer contribution rate by approximately 0.5 percent starting in 2021-22, over the next three decades. The Administration's chart below displays the impact of the supplemental payment towards the employer's contribution rate.

Supplemental Pension Payments to CalSTRS—School Employer Liability Share Estimated Impact					
Fiscal Year	Current		With Supplemental Pension Payment		Savings from Supplemental Pension Payment (in Millions)
	Employer Contribution Rate	Employer Contribution (in Millions)	Employer Contribution Rate	Employer Contribution (in Millions)	
2019-20	18.13%	\$ 6,277	17.10%	\$ 5,927	\$ 350
2020-21	19.10%	\$ 6,844	18.10%	\$ 6,494	\$ 350
2021-22	18.40%	\$ 6,837	17.90%	\$ 6,641	\$ 196
2022-23	18.40%	\$ 7,047	17.90%	\$ 6,883	\$ 164
2023-24	18.40%	\$ 7,301	17.90%	\$ 7,131	\$ 170
Total Savings—2019-20 through 2023-24					\$ 1,230
Total Savings—2024-25 through 2045-46					\$ 5,691
Total Savings—2019-20 through 2045-46					\$ 6,921

Note: The employer contribution rate, with and without the impact of the supplemental pension payments, is projected to remain constant from 2023-24 through 2045-46. Unlike the state contribution rate, asset smoothing (smoothing the impact of investment volatility on the rate) does not have a material impact on the employer contribution rate over this period.

Estimated Savings from Supplemental Payment Proposal to the State Liability Share to CalSTRS. The Governor proposes a \$1.1 billion Proposition 2 funds payment in 2019-20, and \$1.8 million Proposition 2 funds payment through 2022-23 to pay down the state's share of the CalSTRS defined benefit unfunded liability. The Administration estimates a gross savings of \$7.4 billion (\$4.4 billion net), and will reduce the state contribution rates starting in 2022-23 by 0.5 to 0.6 percent over the next 30 years. The Administration notes that the impacts of these savings are contained within the CalSTRS Funding Plan, and will help improve the system's ability to reach fully funded status per the CalSTRS Funding Plan.

According to the Administration, the state's share of the CalSTRS defined benefit program is 85 percent funded as of June 30, 2017. The Administration's chart below displays the impact of the supplemental payment towards the state's contribution rate.

Supplemental Pension Payments to CalSTRS—State Liability Share Estimated Impact					
	Current		With Supplemental Pension Payments		
Fiscal Year	State Contribution Rate	State Contribution (in Millions)	State Contribution Rate	State Contribution (in Millions)	Savings from Supplemental Pension Payments (in Millions)
2019-20	7.83%	\$ 2,569	7.83%	\$ 2,569	\$ -
2020-21	8.33%	\$ 2,786	8.33%	\$ 2,786	\$ -
2021-22	8.83%	\$ 3,057	8.83%	\$ 3,057	\$ -
2022-23	9.30%	\$ 3,330	8.80%	\$ 3,149	\$ 181
2023-24	9.20%	\$ 3,395	8.60%	\$ 3,184	\$ 211
Total Savings—2019-20 through 2023-24					\$ 392
Total Savings—2024-25 through 2045-46					\$ 7,057
Total Savings—2019-20 through 2045-46					\$ 7,449

Note: It is projected that with the supplemental pension payments, the state contribution rate will continue to decrease slightly during the period from 2024-25 through 2045-46, to 8.2 percent. Absent the supplemental pension payments, it is projected that the state contribution rate will decrease to 8.8 percent by the end of this same period. The slight decrease in the state contribution rate over this time period can be attributed to asset smoothing (smoothing the impact of investment volatility on the rate).

Legislative Analyst's Office Comments

Short- and Long-Term Trade-Off. The LAO notes that district pension costs typically are covered using Proposition 98 General Fund; however, the Governor proposes using non-Proposition 98 General Fund for this proposal. Whereas this proposal would provide districts with perceptible budget relief over the next two years, the LAO notes that using the \$700 million instead to pay down more of the CalSTRS unfunded liability would provide a longer-term benefit. Although over the long-term the districts' CalSTRS rate would be only slightly lower than it would be otherwise, the value of a making a \$700 million unfunded liability payment now would grow over time. Such future relief could be important during the next economic downturn.

State Might Not Achieve Savings From Contribution to CalSTRS Before 2046. CalSTRS' limited rate setting authority dampens the expected savings to the state compared to what the Administration initially asserted. Using actuarial assumptions about investment returns, which is based on one scenario where precise actuarial assumptions materialize over the next 30 years, CalSTRS estimates that the proposed \$1.1 billion payment to the state's share of the unfunded liability would result in \$2 billion net savings through 2046. While the LAO does not have stochastic analysis, which examines a range of possible outcomes based on many scenarios, for this particular payment, the LAO notes that there is a roughly 15 percent and 20 percent probability it would show that the state will achieve no savings before 2046. In these scenarios without savings by 2046, CalSTRS actuaries indicate that savings would materialize after 2046. In addition, the average savings ratio under the stochastic analysis is lower than the actuarial estimate.

School Funding Is at Historically High Level and Growing. Most districts identify rising pension costs as one of their most significant fiscal challenges. School funding; however, has grown by nearly \$22 billion (37 percent) over the past six years, significantly outpacing growth in pension costs. Adjusted for inflation, school and community college funding per student is at its highest level since the passage of Proposition 98. Under the Governor's 2019-20 budget, school and community college funding continues to grow, increasing a projected 3.6 percent. Though districts view rising pension costs

as difficult to manage today, these difficulties will be much more pronounced if the state were to enter a recession and Proposition 98 funding were to drop.

Consider Setting Aside Funding for Future Rate Relief. Rather than providing districts with budget relief over the next two years, the state could modify the Governor's proposal to provide rate relief during the next economic downturn. Under this alternative, the state would set aside funds for school district retirement costs, but not immediately adjust district contribution rates. Later, during a downturn, the Legislature could choose when to apply the additional funds and reduce district rates. Such an approach is beneficial because it mitigates the need for pension rate increases at a time when districts would have less funding and be facing even more difficult budget choices.

State's Cash Position Varies Throughout the Fiscal Year. Cash flows in the General Fund can swing widely throughout the year. In particular, the state usually faces seasonal cash deficits during the early months of the state fiscal year. Cash surpluses are more common during the second half of the fiscal year. This is because state tax collections are concentrated in the second half of the fiscal year, especially in April (the annual income tax payment deadline), January, and June.

Resources Available Based on Projections. The current estimate of the surplus available to allocate for the upcoming fiscal year is largely based on projections of revenues for the next 16 months. (Some of this surplus is attributable to actual revenues received through the end of 2018.) These estimates are inherently uncertain. Actual revenues over the next year could be lower or higher than current projections by billions of dollars.

Governor Proposes Debt Repayments Early in Fiscal Year, Limiting Flexibility. The Governor proposes making some key debt repayments in the first month of the 2019-20 fiscal year (although the payments would be attributed to 2018-19). Notably, the Governor proposes transferring \$7.1 to California Public Employees' Retirement System (CalPERS) and CalSTRS in July 2019. When an employer—including the state—makes a contribution to a pension fund, the employer has no legal right to withdraw the funds at a future date. This means that, once transferred in July 2019, the state would no longer be able to revisit these transfers, even if revenues in 2019-20 end up being significantly below expectations. In this case, the Legislature would only have the option to make adjustments to other parts of the budget (such as by lowering programmatic expenditures).

The proposed state contribution to CalSTRS would make progress toward addressing the system's unfunded liability, but might not achieve as much state savings as other options. The Legislature might want to consider maximizing state savings as the highest priority when considering how to make supplemental payments to retirement benefits. One option for maximizing state savings would be to concentrate pension supplemental payments on behalf of the state to CalPERS.

Staff Comments

For the year to date, revenues are below projections by a total of \$2.2 billion, due to January revenues coming in significantly below projections. The LAO and others believe much of the January shortfall was due to timing of payments and expect that some of shortfall may be made up in April payments. Since this proposal is a part of the overall architecture of the budget, the Legislature may wish to wait until update revenue projections are available before approving this proposal.

Staff Recommendation, Hold Open.

7900 CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

The California Public Employees' Retirement System (CalPERS) administers retirement benefits for about two million active employees and retirees of state and local agencies in California as of June 30, 2018. Benefits include retirement, disability, and survivor retirement benefits. CalPERS also provides health benefits for approximately 1.5 million active and retired state, local government, and school employees and their family members as of June 30, 2018. CalPERS develops, negotiates, and administers contracts with health maintenance organizations, group hospitals, and medical insurance plans. In addition, CalPERS administers a long-term care program for members and eligible individuals. CalPERS is governed by a Board of Administration, which is composed of 13 members: six elected members, three appointed members, and four ex-officio members. The California Constitution provides the CalPERS Board of Administration authority over the administration of the retirement system with the exception of the Health Benefits Program. The total fiduciary net position in the Public Employees' Retirement Fund (PERF) was \$354 billion as of June 30, 2018.

CalPERS Budgeted Expenditures and Positions
(Dollars in Millions)

	2017-18	2018-19	2019-20
Retirement	\$93.5	\$106.3	\$106.3
Health Benefits	\$64.8	\$74.4	\$74.4
Investment Operations	\$68.7	\$74.1	\$74.1
Administration	\$192.7	\$217.3	\$218
Benefit Payments	\$27,776	\$29,480	\$31,244
Unscheduled Items of Appropriation	N/A	\$3,000*	N/A
Positions	2,708	3,005	3,005

*The Administration's 2019-20 budget proposes a supplemental payment of \$3 billion General Fund payment in 2018-19 to address the CalPERS unfunded liability.

Issue 5: Supplemental Pension Payment

Background

State Makes Annual Pension Contributions. The state provides pension benefits to retired state employees through CalPERS. CalPERS state pensions are funded by three sources: investment gains, employer contributions from the state, and employee contributions. The state's contributions have been rising (due to actuarial assumption changes and lower-than-assumed investment returns) and are expected to continue to rise over the next several years. Specifically, the state's CalPERS pension contributions are expected to increase by more than 25 percent between now and 2023-24.

Unfunded Liability. Unfunded liabilities occur when assets on hand are less than the estimated cost of benefits (liabilities) earned to date. According to the Department of Finance, the state's current unfunded pension liability for CalPERS is \$58.7 billion. As of June 30, 2017, the funded status for CalPERS was 67 percent.

Public Employees' Pension Reform Act (PEPRA). In January 2013, PEPRA modified the way CalPERS retirement and health benefits are applied, placing compensation limits on members, with the greatest impact on new employees hired after January 1, 2013. Below is a brief summary of some of the components of PEPRA.

- **Reduced Benefit Formulas and Increased Retirement Ages** – PEPRA established retirement benefits of two percent of the employee's final compensation at age 62 for all new miscellaneous (non-public safety) members with an early retirement age of 52, and a maximum benefit factor of 2.5 percent at age 67. PEPRA also created three defined benefit formulas for new safety members. Previously, the benefit formula was two percent of the employees final compensation at age 55 for state employees hired between January 15, 2011 and December 31, 2012, and two percent of the final compensation at age 60 for new employees hired prior to January 11, 2011.
- **Capped Pensionable Compensation** – Caps the annual salary that can be used to calculate final compensation for new members, excluding judges, at \$113,700 for employees that participate in Social Security, or \$136,440 for those who do not, which may be adjusted based on changes to the consumer price index. Previously, first-time members hired after January 1, 1996 had a compensation cap, which was set by the Internal Revenue Service and was referred to as the 401(a)(17) limit.
- **Equal Sharing for the Normal Costs** – For public agencies, schools employers, the California State University, and the judicial branch, a new member's initial contribution rate will be at least 50 percent of the total normal cost rate or the current contribution rate of similarly situated employees, whichever is greater, except as provided in an existing memoranda of understanding.

Starting January 1, 2018, public agency and school employers that collectively bargained may require classic members to pay up to 50 percent of the total normal cost of their pension benefit after certain conditions are met. However, the employee contribution can only be increased by specified percentages for various classifications.

Additionally, CalPERS has rate setting authority and employer and member rates are examined every year in the fall. Changes are reported through the Annual Valuation Report provided to each employer.

CalPERS Employer Contribution Rates Are Increasing. In December 2016, the CalPERS governing board voted to lower its discount rate (investment return assumption) from 7.5 percent to seven percent over three years. In 2019-20, the discount rate will be seven percent for state employers. By assuming less money comes into the system through investment gains, the state will be required to contribute more money to pay for current and future pension costs as well as a larger unfunded liability. As a result of this and other assumption changes, average employer contribution rates are projected to rise over the next few years.

State employee salaries are paid by the General Fund or other funds, depending on the employees' work. Employee benefits—like pensions—are paid by the same fund as the employees' salaries. Employer contributions to CalPERS are based on payroll. Some funds—like the Motor Vehicle Account (MVA)—primarily support operations performed by state employees (such as registering vehicles), and therefore have relatively high associated state pension costs. Other funds primarily pass funding through to local governments and therefore do not support many state employees and as such have low state pension costs. When employer contribution rates rise, the associated costs to each fund also rise. The LAO chart below displays the major funds making contributions to the five state CalPERS plans.

Major Funds Making Pension Contributions by CalPERS Plan

	Share of Contributions
Miscellaneous	
General Fund	37%
Federal Funds	11
State Highway Account	8
CSU Trust Fund	6
Motor Vehicle Account	5
Industrial	
General Fund	97%
Prison Industries Revolving Fund	2
Safety	
General Fund	89%
Motor Vehicle Account	4
Prison Industries Revolving Fund	1
Peace Officers and Firefighters	
General Fund	90%
State Parks and Recreation	1
Motor Vehicle Account	1
Highway Patrol	
Motor Vehicle Account	96%
State Highway Account	3

2017-18 Pension Borrowing Plan. SB 84 (Committee on Budget and Fiscal Review), Chapter 50, Statutes of 2017, approved the Governor's May Revision proposal to borrow \$6 billion from the state's cash balances in the Pooled Money Investment Account (PMIA) to make a one-time supplemental payment to CalPERS. The Administration estimated gross savings of \$11.8 billion (\$4.8 million net savings) from this payment. While annual state pension contributions will continue to rise over the next several years, CalPERS estimates this supplemental payment would reduce the required contribution for 2018-19 by approximately \$177.3 million. The Administration notes that of the \$6 billion principal amount, the remaining balance is about \$5.8 billion.

On September 28, 2017, the Department of Finance submitted a letter to the Joint Legislative Budget Committee regarding the supplemental payment, which included various stochastic models. According to the analysis, the plan has a 95 percent chance to save the state money. The median scenario from the analysis suggests the plan would save the state \$3.1 billion over 20 years. The actual savings associated with the plan may be higher or lower than this amount, potentially by billions of dollars, depending on a variety of factors, most notably CalPERS' future investment performance.

Governor's Budget Proposal

State's CalPERS Unfunded Liability. The Administration proposes a \$3 billion supplemental payment to CalPERS in 2018-19, and payment to each state plan would be a proportionate share of the required General Fund contribution. The proposed trailer bill language provides the Department of Finance the authority to determine the schedule and timing of the fund transfer. Additionally, the trailer bill language specifies that of the funds, up to approximately \$1.4 billion would be transferred to the state miscellaneous plan, \$81.5 million to the state industrial plan, \$178.3 million to safety plan, and \$1.4 million to the state peace and firefighter plan. Since the highway patrol plan does not make General Fund contributions, it would not receive a payment under the proposal.

Savings Would Be Distributed Among All Funds That Make Pension Contributions to Plans. With the payment, the employer contribution rate is expected to be around one percent of pay lower each year until nearly 2040—representing an average of around \$225 million in savings per year. In total, this investment would create net savings of \$6.3 billion in net savings over about 30 years.

The savings each plan receives would be distributed proportionally to each fund that pays its pension costs. For the four plans receiving a payment, this means the benefit of the payment would be distributed proportionally across all contributing funds. Consequently, the General Fund would only receive \$6 billion of the total \$9.3 billion in gross savings. Because the General Fund would pay the full \$3 billion supplemental payment, its net savings would be \$3 billion. All other funds would receive a respective share of the gross savings. Under the median stochastic scenario, federal funds would receive savings of \$500 million, the State Highway Account would save \$340 million, the California State University Trust Fund would save \$255 million, and the MVA would save \$260 million. The LAO chart on the following page displays the anticipated payment and savings by state plan under the Governor's proposal.

Anticipated Payment and Savings by CalPERS Plan under the Governor's Proposal
(In Billions)

Plan	Total Contribution	Gross Savings	Net Savings
Miscellaneous	\$1.4	\$4.3	\$2.9
Industrial	0.1	0.3	0.2
Safety	0.2	0.6	0.4
Peace Officer/Firefighter	1.4	4.1	2.7
Highway Patrol	—	—	—
Totals	\$3.0	\$9.3	\$6.3

Other Contributions. The budget also includes a statutorily required annual contribution of \$6.8 billion (\$3.9 billion General Fund) to CalPERS for state pension costs, of which \$727.5 million General Fund is for California State University retirement costs. The estimated \$566 million increase is the net effect of changes in actuarial assumptions, including the lower discount rate adopted by the CalPERS Board in 2016, savings from greater investment returns, and the \$6 billion supplemental pension payment the state made to CalPERS in 2017-18.

2017-18 Loan Repayment. An additional \$390 million in Proposition 2 debt funding is included in the budget to pay down the General Fund's share of the loan that funded the 2017-18 supplemental pension payment.

Legislative Analyst's Office Comments

The LAO notes that the Governor's proposal has a few shortcomings. Specifically, the proposal:

- **Does Not Maximize General Fund Benefit.** The major shortcoming associated with the Governor's plan is that it generates much less benefit for the General Fund than it could. That is because the General Fund only would accrue a part of the savings derived from the plan, but it would make the entire supplemental payment.
- **Provides Benefits to Federal Funds Without Reimbursement.** While most of the funds that would benefit from the plan are operated by the state, some are not. In particular, federal funds would benefit by \$500 million. Under the Governor's plan, the state would not seek reimbursement for the state payment that results in this federal benefit.
- **Provides Little Benefit to the MVA.** There are concerns about the fiscal condition of the MVA, a major state fund that makes significant pension contributions. In 2018-19, the MVA faces an operational shortfall of almost \$400 million. Absent corrective actions, the account likely again would experience an operational shortfall in 2019-20 and potentially become insolvent in the future. Although pension costs only explain a part of the MVA's growing imbalance, addressing rising pension costs in the MVA could play a role in improving the long-term solvency of the fund. The Governor's proposal would result in slightly lower pension costs for the MVA, but because no supplemental payment is made to the Highway Patrol plan, the benefit is much smaller than it could be.

Alternative Payment Options. The LAO offers a few alternative strategies for the supplemental payment.

1. **Keep DOF Distribution, but Require Other Funds to Repay General Fund.** A first alternative to the Governor's proposal would be to keep DOF's proposed distribution of payments by plan, but require funds that benefit from this plan to repay the General Fund. Under this alternative, the \$3 billion would still be distributed to only four of the five plans, but funds would repay \$1 billion, over time, back to the General Fund for their shares of the contribution. (Many funds might not have the resources to repay the General Fund right away, but could use their accrued savings from lower pension payments over time to make these repayments.)
2. **Distribute the Payment Based on Unfunded Liability and Require Repayments.** If the Legislature wanted to make a payment to all CalPERS plans, it could distribute the payment according to each plan's unfunded liability and require the benefiting funds to repay the General Fund in proportion to their benefit. Under this second alternative, the \$3 billion would be distributed among all five plans and other funds would repay \$1.5 billion to the General Fund.

In addition to proportionally allocating benefit among all employee types, this alternative would maximize potential savings for the MVA, somewhat reducing the fund's ongoing structural imbalance. Lower pension payments—and a net benefit of roughly \$700 million over 30 years—could put the fund in a slightly better condition over the long-term.

3. **Make Full Payment to Peace Officers and Firefighters Plan.** One concern about administering the proposal using repayments is the administrative complexity involved. While the state is already administering repayments for the 2017-18 CalPERS supplemental payment, DOF has noted this is administratively burdensome for them and the State Controller's Office. A third alternative, which would maximize General Fund benefit without a complicated repayment system, would make the entire supplemental payment to Peace Officers and Firefighters plan. This plan is nearly entirely General Fund supported and the vast majority of the benefit would still accrue to the General Fund. The state could generate over \$5 billion net savings, which is the most General Fund benefit of the proposals.

Anticipated Payments and Savings by CalPERS Plan under Alternative Proposals
(In Billions)

Plan	Governor's Plan and Alternative 1 (DOF With Repayments)		Alternative 2 (UFL With Repayments)		Alternative 3 (POFF)	
	Total Contribution	Gross Savings	Total Contribution	Gross Savings	Total Contribution	Gross Savings
Miscellaneous	\$1.4	\$4.3	\$1.8	\$5.6	—	—
Industrial	0.1	0.3	0.1	0.2	—	—
Safety	0.2	0.6	0.1	0.5	—	—
Peace Officer/Firefighter	1.4	4.1	0.8	2.3	\$3.0	\$9.0
Highway Patrol	—	—	0.3	0.8	—	—
Totals	\$3.0	\$9.3	\$3.0	\$9.3	\$3.0	\$9.0

Ensuring Funds Pay Their Shares, Including Federal Funds. Another key disadvantage of the Governor’s plan is that it delivers benefit to the federal government without asking the federal government to pay its proportionate share. All of the other alternatives would involve requesting that the federal government reimburse the state for its share of the initial payment. That said, it is not necessarily guaranteed that the federal government would agree to make these payments. The state is still working with a federal negotiator to request repayments on the federal share of the initial 2017-18 CalPERS supplemental payment and has not yet received a final decision.

Suggest the Legislature Consider Alternative 2 for Supplemental Payment. While relatively administratively simple, the Governor’s proposal would result in the smallest General Fund savings of the four options. The two alternatives that provide the greatest General Fund benefit—Alternatives 1 and 3—create preferential treatment by not benefitting all employee groups. In addition, neither of these alternatives create much benefit (if any) for the MVA—a large fund that faces fiscal pressure as a result of rising pension costs. As such, the Legislature may have a preference for Alternative 2, which would distribute the payment by unfunded liability to the various plans and require each fund that benefits—including federal funds—to repay the General Fund for their shares of the initial payment. As shown in the figure below, Alternative 2 creates slightly more General Fund benefit than the Governor’s proposal, but also ensures all plans and funds, including MVA, derive their proportionate share of benefit from the supplemental payment.

Summary of Alternative Options
(In Billions)

	Net General Fund Benefit	Net MVA Benefit	Provides Benefits to Some or All Plans?				
			Miscellaneous	Industrial	Safety	POFF	Highway Patrol
Governor’s Plan	\$3.0	\$0.3	✓	✓	✓	✓	
Alternative 1: DOF with repayments	4.1	0.2	✓	✓	✓	✓	
Alternative 2: UFL with repayments	3.2	0.7	✓	✓	✓	✓	✓
Alternative 3: POFF	5.1	0.0				✓	
MVA = Motor Vehicle Account; POFF = Peace Officer/Firefighter; DOF = Department of Finance; and UFL = unfunded liability.							

Staff Comments

The Administration notes that the payment is proposed for 2018-19 due to the estimated availability of General Fund this year, and that there is no long-term savings impact if the payment is applied on June 30, 2019, as compared to January 1, 2020. The proposal also assumes an investment return of 8.6 percent for 2017-18 (which is based on the most recent actuarial report from June 30, 2017), and seven percent for 2018-19 and thereafter.

The Governor's proposal provides significant spending in 2018-19. The Legislature may wish to wait until update revenue projections are available before approving this proposal. As the Legislature evaluates the Governor's proposal, it may wish to consider what its priorities are on how the funds (1) maximizes General Fund benefit, (2) provides benefit to the MVA—a large fund that faces fiscal pressure as a result of rising pension costs and other cost pressures, and (3) distributes benefits to all CalPERS plan types.

CalPERS Amortization Base Period. As noted previously, the 2017-18 budget provided a \$6 billion PMIA loan to pay down the CalPERS unfunded liability. DOF estimated that the \$6 billion payment in 2017-18 would result in net savings of \$5 billion. For the 2019-20 budget, DOF indicates that the proposed \$3 billion supplemental pension payment would result in a net savings of \$4.2 billion. The Administration notes that the difference in savings can be explained by how much savings can be achieved by the amortization base to which the payment is applied.

Actuarial gains/losses in each year are amortized over a period of time specified by CalPERS board policies. The gain or loss in each year is called an "amortization base." Previously, actuarial gains/losses were amortized over a 30-year period. However, in February 2018, the CalPERS board adopted a new policy that, beginning with the June 30, 2019 valuation (first affecting the 2020-21 contribution rates), will amortize any new gains/losses over a 20-year period. The 2017-18 \$6 billion supplemental payment to CalPERS was amortized over a 20-year period.

The Governor's proposal applies the \$3 billion supplemental payment to the 2016 amortization base, which had a 30-year amortization period. This base was chosen because it is the most recent amortization "loss" base. There are 27 years remaining in the amortization schedule to pay down this loss. By applying the payment to this amortization base, the benefit of the \$3 billion supplemental payment would be spread out over 27 years to maximize savings.

Similar to the Governor's proposal on CalSTRS, this proposal is a part of the overall architecture of the budget, the Legislature may wish to wait until update revenue projections are available before approving this proposal.

Staff Recommendation. Hold Open.

DEFERRALS

Issue 6: Payroll Deferral Trailer Bill Language and CalPERS Deferral

Background

Payroll Deferral. The 2009-10 budget package included an ongoing one-month deferral of June state payroll to early July, providing savings for the state. This accounting action did not affect when paychecks were issued to state employees. Because payroll costs grow over time, the deferral continues to provide ongoing savings for the state General Fund. For example, in 2016-17, the associated General Fund benefit was \$65 million (savings vary from year to year depending on how payroll costs are growing). Undoing this deferral would eliminate this annual benefit.

CalPERS Deferral. The state makes quarterly payments to CalPERS for pension contributions for state employees. The state pays the fourth-quarter contribution to CalPERS in the first quarter of the subsequent fiscal year. This means the state makes the transfer in the first few days of July. This deferral only applies to the state's General Fund pension payments. For cash purposes, the state also defers other payments to CalPERS throughout the fiscal year. For example, a portion of the third-quarter payment is transferred in mid-April, rather than the end of March. Because pension costs grow over time, this deferral provides ongoing savings for the General Fund. For example, in 2016-17, this General Fund benefit was \$56 million (savings vary from year to year depending on how pension costs are growing).

Governor's Proposal

The Governor proposes trailer bill language to repeal sections of the Government Code to eliminate the state payroll deferral. The Administration estimates the cost to undo this action will be \$973 million for the General Fund. The state never recognized the deferral in other funds' budgetary statements and, as a result, undoing it would only have budgetary implications for the General Fund.

There is no trailer bill to undo the CalPERS deferral. This change is reflected in the Department of Finance's summary schedules. Specifically, this is reflected in Schedule 9 regarding comparative statements of expenditures. Undoing the deferral would eliminate these savings. The Administration estimates the cost to undo this action is \$707 million General Fund (other funds' fourth quarter CalPERS payments are not deferred).

The Administration notes that the intent of the proposals is to reuse this tool in the future.

Legislative Analyst's Office Comments

The LAO notes that the Governor's proposal to end the payroll and pension deferrals has the following implications:

- **Improves the State's Fiscal Position.** The Governor's proposal to undo the payroll and pension deferrals would allow the state to take these actions again in the future (essentially, carrying a reserve-like benefit). However, undoing and redoing deferrals involves more administrative complexity.

- **Moderately Improves the State's Fiscal Transparency and Budgetary Practices.** Undoing the pension and payroll deferrals could moderately improve the state's fiscal transparency and budgetary practices. In particular, the payroll deferral results in an inconsistency between the state's fund condition statements (published on a budgetary basis) and the state's official accounting reports (published consistent with generally accepted accounting principles). Undoing the payroll deferral would reconcile these reports. The Administration has recently indicated that improving the state's budgetary practice is its current rationale for proposing to undo these deferrals.
- **Does Not Reduce Adverse Effects on Other Entities.** Neither the payroll nor the pension deferral carries notable adverse consequences for any nonstate entities. The payroll deferral does not affect when state employees receive their paychecks. The pension system does not experience adverse consequences from receiving funds in early July rather than late June.

The LAO also notes that there are other alternatives that the state could use \$1.7 billion, and recommends the Legislature reject the Governor's proposal to undo the payroll and pension deferral because they provide ongoing budgetary savings.

Specifically, the LAO recommends the Legislature instead use \$1.7 billion to reverse the fee-for-service (FSS) Medi-Cal deferral (\$300 million) and use the remaining \$1.4 billion to build more reserves, which could generate investment returns for the state. In FSS, the state makes weekly payments directly to health care providers. Deferred payments in Med-Cal means that managed care plans and some health care providers face a gap in payments at the end of the state fiscal years, and entities must arrange their finances to cover this gap. Entities that receive a high percentage of their total revenue from Medi-Cal, small entities with fewer resources, or entities that receive most of their Medi-Cal payments through the FSS are the most impacted by this deferral. Some specific examples are rural hospitals with a high amount of Medi-Cal patients, and providers of family planning services, such as Planned Parenthood.

Staff Recommendation. Hold Open.

7501 CALIFORNIA DEPARTMENT OF HUMAN RESOURCES**Issue 7: Nonindustrial Disability Insurance****Background**

Chapter 2.6 of Part 2.6 of Division 5 of Title 2 of the Government Code provides nonindustrial disability insurance (NDI) benefits for rank-and-file state employees and excluded employees who are temporarily or permanently disabled due to a non-work related injury or medical condition. NDI benefits are up to a specified amount each week for up to 26 weeks for any one disability period, unless otherwise specified in a memorandum of understanding. Currently, 12 of the 21 state bargaining units are enrolled in the NDI program. NDI is an employer funded program.

NDI benefits have two structures: (1) if the employee is enrolled in the annual leave program, they receive 50 percent of their gross pay, and (2) if the employee is enrolled in sick and vacation program, they receive up to \$135 per week. The annual leave program replaces the traditional vacation and sick leave program with a more flexible leave and the hours of annual leave accrual is typically less than vacation and sick leave. Employees are able to switch from the sick leave and vacation program to the annual leave program, or vice versa, after they have been in the program for at least 24 months. Currently, NDI and sick and vacation leave costs approximately \$21 million annually. Currently, employees enrolled in the annual leave program are able to supplement their NDI with leave credits to obtain 75 percent or 100 percent of their pay; however, employees enrolled in the sick and vacation leave program do not have the option to supplement their pay.

Per the memorandum of understanding between the state and the Service Employees International Union (SEIU), which represents nine of the 21 state bargaining units (bargaining units 1, 3, 4, 11, 14, 15, 17, 20 and 21), SEIU employees are covered under the State Disability Insurance (SDI). As discussed in a previous hearing, the SDI is an employee funded program that provides short-term disability insurance wage replacement benefits to eligible workers. The paid family leave (PFL) program is a component of the SDI program, which provides wage replacement benefits to care for a seriously ill child, spouse or registered domestic partner, parent, siblings, grandparents, grandchildren, and parents-in-law, or to bond with a child within one year of birth, adoption or foster care placement.

Governor's Budget Proposal

On March 29th, the Administration released trailer bill language to expand NDI benefits for excluded state employees. Specifically, on July 1, 2019, excluded employees enrolled in the annual leave program will be able to take up to six weeks paid time off to care for a seriously ill family member or to bond with a new child. This new benefit would be approximately 50 percent of an excluded employee's salary, with the option to supplement with leave for full salary. On July 1, 2021, family care leave under the NDI program will be expanded to cover qualifying exigency leave related to the covered active duty or call to covered active duty of the employee's family member in the U.S. Armed Forces.

Staff Comments

According to the Administration, this program is to provide excluded employees parity to what they might have been eligible to receive as rank-and-file employees under the SDI program for family care

leave and bonding time with a new child. In 2018, there were approximately 41,600 excluded state employees, of which, 46.6 percent were enrolled in the annual leave program. This means that approximately 19,000 excluded state employees would be eligible for this new benefit. This additional benefit would cost approximately \$4.3 million (\$1.9 million General Fund); however, the Administration notes that the departments are expected to absorb this additional cost.

On March 23rd, the subcommittee heard an item related to PFL. At the time, the Administration did not have a specific proposal, however the Governor's budget summary noted that it seeks to allow a child to receive up to six months of bonding time to be split between parents or close relative. On April 11th, the Administration released trailer bill language regarding the Governor's proposal. Staff is still reviewing the proposal and will provide an in-depth analysis of the proposal at a future hearing. Based on a preliminary review of the proposal, the Administration seeks to expand PFL from up to six weeks to eight weeks starting on July 1, 2020. On July 1, 2019, the fund reserve for the disability fund would decrease from 35 to 45 percent to approximately 25 to 35 percent of annual disbursements. Lastly, in the findings and declarations, the trailer bill proposes that by November 2019, the Administration, in consultation with a taskforce, will develop a proposal to increase PFL to up to six months by 2021-22.

As currently proposed, the Administration's NDI and PFL proposals have different length of leave times (NDI with up to six weeks and PFL up to eight weeks). If the goal is to create benefit parity between excluded employees and rank-and-file employees enrolled in the SDI, the subcommittee may wish to consider how these proposals impact each other. Additionally, under the Governor's proposal, excluded employees who are enrolled the sick and vacation leave program, which 53.4 percent participate in, are not eligible for this extended benefit. The subcommittee may wish to ask the Administration what the rationale is for only allowing excluded employees enrolled in the annual leave program to be eligible for this benefit.

Given these questions and ongoing analysis, staff recommends holding this item open.

Staff Recommendation. Hold Open.

7300 AGRICULTURAL LABOR RELATIONS BOARD (ALRB)**Issue 8: Continued Funding for the Agricultural Labor Relations Board****Governor's Budget Proposal**

To address workload since fiscal year 2015-16, the ALRB, Office of the Board is requesting \$593,000 General Fund to convert 2.5 limited-term positions to permanent. The Office of the Board (Board) requests permanent funding of \$593,000 General Fund for existing limited-term positions: 1.5 Hearing Officer II positions and one Attorney IV position. These positions have been limited-term for four years and the workload for these positions has not decreased. ALRB's objective is to resolve legal matters in a proactive and timely manner for our stakeholders and thereby advance the policies of the Agricultural Labor Relations Act. The request for permanent funding will provide the Board with resources to continue to achieve that objective and ALRB's mission.

The 1.5 hearing Officer II positions have allowed the Board to maintain no backlog and continue to schedule hearings within a 60 to 90 day timeframe. Prior to these resources being added in 2015-16, it took between 200 and 600 days to schedule a hearing. According to the Administration, the process begins when the complaint is issued and the respondent has 10 days to provide an "answer." Once the answer is received, the ALRB has 10 days to set the case for hearing. Following this, there is a case management conference, which occurs 10 days after the hearing is set. Then a pre-hearing conference occurs typically within 21 days after the case management conference. Approximately 21 days after the prehearing conference, the first day of the hearing occurs.

The Board requests a permanent augmentation for the Attorney IV position. Permanently augmenting the Attorney IV position will avoid additional legal expenditures and is the most efficient means to meet the Board's workload and provide continuity in case litigation.

Staff Recommendation. Approve as proposed.

7120 CALIFORNIA WORKFORCE DEVELOPMENT BOARD (CWDB)**Issue 9: Assembly Bill 1111 (E. Garcia), Chapter 824, Statutes of 2017****Background**

AB 1111 established the Breaking Barriers to Employment Initiative for the purpose of assisting individuals who have multiple barriers to employment to receive the remedial education and work readiness skills to help them to successfully participate in training, apprenticeship, or employment opportunities that will lead to self-sufficiency and economic stability.

This grant targets a broad array of populations, which includes: (1) youths who are disconnected from the education system or employment, (2) women seeking training or education to move into nontraditional fields of employment, (3) displaced workers and long-term unemployed, (4) unskilled or under-skilled, low-wage workers, (5) persons for whom English is not their primary language, (6) economically disadvantaged persons, (7) CalWORKs participants, (8) persons who are incarcerated and soon to be released or formerly incarcerated, (9) armed services veterans, (10) Native Americans, (11) migrants or seasonal farmworkers, (12) persons with developmental or other disabilities, (13) immigrants, and (14) persons over 50 years of age who need retraining for in-demand skills, among others.

AB 1111 funds are to supplement and not supplant state or federal funding for programs. This grant is eligible for a broad array of activities, which includes: (1) English language improvement training, (2) basic skills and adult education, (3) high school diploma and General Education Development (GED) acquisition, (4) skills and vocational training that aligns with regional labor market needs identified as part of the California Workforce Innovation and Opportunity Act regional planning process, (5) work experience, (6) on-the-job training, (7) stipends for trainees, (8) earn and learn training, (9) Industry certifications, (10) pre-apprenticeship, and (11) mentoring, among others.

The Assembly Floor Analysis for the final version of the bill (September 8, 2017), stated that the bill would result in an unknown cost pressure to fund a grant program. State administrative costs would depend upon the size of the grant program. For illustrative purposes, the analysis states that for a future appropriation of \$10 million, the grant will incur administrative costs of approximately \$430,000. In addition, the Employment Development Department (EDD) generally serves as the fiscal agent for grant programs managed by CWDB. EDD's administrative costs are generally five to ten percent of grant funding. However, its costs can vary considerably depending on 1) the total amount of grant funding available, 2) the number of grants awarded, 3) the number of funding rounds, 4) legal challenges, and 5) the complexity of reporting requirements. Thus, based on a \$10 million appropriation, EDD's costs would be up to \$1 million.

The Department of Finance legislative analysis for AB 1111 is not publically available.

The 2018-19 budget act provided \$15 million one-time General Fund for AB 1111 and funds are available for encumbrance or expenditure until June 30, 2020, and for liquidation until June 30, 2022. The budget bill also capped state operations and administrative expenditures to five percent or \$750,000.

Governor's Budget Proposal

The Governor requests six positions (one staff services manager I, one research analyst II, and four associate governmental program analysts) and redirection of \$914,000 General Fund in 2019-20, and \$1.2 million in 2020-21 and 2021-22 to administer and oversee the AB 1111 grant. This results in a total of \$3.3 million or 22 percent redirection from the \$15 million grant that was approved in the 2018-19 budget.

CWDB notes that they plan to provide assistance to grantees and work closely with grantees through the life of the grant. They plan to provide frequent project check-ins, resolve issues, and offer technical support. Managers and analysts will develop community of practice for each program to build support network for grantees to learn from each other through meetings, webinars, and conference calls. Program managers oversee the development of materials from policy briefs to best practices, highlighting solutions.

Staff Comments

In 2018-19, CWDB had 29.9 employees with two positions currently vacant. The Administration notes that the additional redirection of funds is more than just CWDB administrative costs, but also program costs such as training, coordination, technical assistance and outcomes reports and evaluation for CWDB as well as EDD contract costs associated with legal, compliance, and processing of payments. CWDB notes these costs are as follows: \$889,674 for CWDB administrative costs, \$816,248 for EDD administrative costs, \$174,004 for EDD program costs, and \$2.17 million for CWDB program costs. The Governor's request for administrative and technical support is significantly larger than what was contemplated in the 2018-19 budget act. The Legislature may wish to consider whether or not this is the appropriate amount of funding for this purpose.

Staff Recommendation. Hold Open