

# **SUBCOMMITTEE NO. 4**

# **Agenda**

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**Senator Richard D. Roth, Chair**  
**Senator Steven M. Glazer**  
**Senator Scott Wilk**



**Thursday, March 15, 2018**  
**9:30 a.m. or upon adjournment of session**  
**State Capitol - Room 2040**

## **PART B**

Consultants: Christopher Francis and Joe Stephenshaw

### **Vote Only Calendar**

<b>Item</b>	<b>Department</b>	
<b>0984</b>	<b>Secure Choice Retirement Savings Investment Board</b>	
Issue 1	CalSavers Program Implementation	2

### **Items Proposed for Discussion**

<b>Item</b>	<b>Department</b>	
	<b>Proposition 2 Proposal</b>	
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<b>0950</b>	<b>State Treasurer's Office</b>	
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<b>0971</b>	<b>Alternative Energy &amp; Advanced Transportation Financing Authority</b>	
Issue 1	Administration of California Hub for Energy Efficiency Financing Pilot Programs	11

Public Comment

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## ISSUES PROPOSED FOR VOTE ONLY

### 0984 CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

#### Issue 1: CalSavers Program Implementation (BCP)

**Governor’s Proposal.** The California Secure Choice Retirement Savings Investment Board (Board) requests a General Fund loan of \$2,500,000 for fiscal year 2018-19 to provide resources for the Board and the CalSavers program including funding for new and existing staff, external consultants, and administrative and overhead costs.

**Background.** The Board and the CalSavers (formerly California Secure Choice Retirement Savings Program) were established pursuant to SB 1234 (de León), Chapter 734, Statutes of 2012, for the purpose of creating a statewide savings plan for private-sector workers who lack access to an employer-sponsored retirement savings plan. The legislation requires that the Board conduct a market analysis, financial feasibility study and legal analysis to determine whether the necessary conditions for implementation of the program can be met. The Board can implement the program only if it determines, based on the market analysis, that the program will be self-sustaining; funds are made available through a nonprofit or other private entity, federal funding, or an annual budget act appropriation, in amounts sufficient to allow the Board to implement the program until the California Secure Choice Retirement Savings Trust has sufficient funds to be self-sustaining; and an authorizing statute is enacted that expresses the approval of the Legislature for the program to be fully implemented.

The Board entered into an agreement with a firm for market analysis, financial feasibility study, and program design work. In addition, the Board entered into an agreement with a firm for legal services. The studies completed in Spring 2016 indicated the financial feasibility and sustainability of the program. The feasibility analysis indicates that about 6.8 million workers are potentially eligible for participation in the program, and the expected level of participation of 70 percent to 90 percent of those eligible is sufficient to enable the program to achieve broad coverage and become financially sustainable. In addition, the feasibility report indicates that potential participants are accepting of a three to five percent contribution rate (based on compensation).

As the Board begins the process of program implementation, the necessity of startup funding to make this possible is apparent. The Board stated that the program is currently on target to launch a pilot program in late 2018 and a full statewide launch in 2019. Between the budgetary savings from 2016-17 and 2017-18, and the \$2.5 million loan request for FY 2018-19, they do not anticipate having to come back in the fiscal year with an additional request.

**Staff Comments.** Staff has no concerns with this proposal.

**Staff Recommendation.** Approve as budgeted.

**Vote:**

## ISSUES PROPOSED FOR DISCUSSION AND VOTE

### PROPOSITION 2 PROPOSAL

#### Issue 1: Proposition 2 Reserve

**Governor’s Proposal.** The Governor’s budget proposes a \$15.7 billion reserve for 2018-19, which includes \$13.5 billion in the Budget Stabilization Account (BSA) and \$2.3 billion in the Special Fund for Economic Uncertainties (SFEU). The BSA reserve level includes a supplemental deposit of \$3.5 billion, in addition to the constitutionally required deposit of \$1.5 billion, bringing the BSA to its constitutional maximum of ten percent of General Fund revenues. The constitutionally required BSA deposit is based on projected General Fund revenues of \$134.8 billion of which \$13.3 billion (9.9 percent) is projected to come from personal income tax on capital gains. The following chart outlines the Governor’s proposed BSA fund.

#### Proposal for Proposition 2 – Rainy Day Fund (Dollars in Millions)

	2018-19
<b>1.5% of General Fund (GF) Revenues</b>	
GF Revenues and Transfers (before BSA transfer)	\$134,835
<b>1.5% of GF Revenues and Transfers</b>	<b>\$2,023</b>
<b>Capital Gain Revenues</b>	
GF Tax Proceeds	\$134,605
Personal Income Taxes from Capital Gains	13,259
Percent of GF Tax Proceeds	9.9%
8% of GF Tax Proceeds	10,768
Excess of 8%	2,491
Prop 98 Share of Capital Gains above 8%	1,444
<b>Non Prop 98 Share of Capital Gains above 8%</b>	<b>\$1,047</b>
<b>Total Available</b>	<b>\$3,070</b>
Debt Repayment (50%)	1,535
<b><i>Deposit to Rainy Day Fund (50%)</i></b>	<b><i>1,535</i></b>
<b><i>Supplemental BSA Deposit</i></b>	<b><i>3,515</i></b>
<b>Total Deposit to the Rainy Day Fund</b>	<b>5,050</b>
<b>Cumulative Balance</b>	<b>\$13,461</b>

In addition to the reserve, the Governor’s budget proposes \$1.5 billion in debt and liability payments pursuant to Proposition 2, as displayed in the following chart.

**Proposal for Debts and Liabilities Payments  
(Dollars in Millions)**

<b>Category</b>	<b>Amount Beginning of 2018-19</b>	<b>Payment in 2018-19</b>
<b>Budgetary Borrowing</b>		
Special Fund Loans and Interest	\$1,248	\$205
Proposition 98 Settle-Up Underfunding	440	100
Weight Fee Payments	1,117	325
Transportation Loans (Pre-Proposition 42)	471	235
<b>Subtotal Debt</b>	<b>\$3,276</b>	<b>\$865</b>
<b>Retirement Liabilities</b>		
State Retiree Health	76,533	195
State Employee Pensions	59,578	475
Teacher Pensions <sup>1</sup>	101,586	0
Judges' Pensions	3,489	0
CalPERS Deferred Payment	682	0
UC Employee Pensions	10,851	0
UC Retiree Health	19,331	0
<b>Subtotal Liabilities</b>	<b>\$272,050</b>	<b>\$670</b>
<b>Grand Total</b>	<b>\$275,326</b>	<b>\$1,535</b>

<sup>1</sup>The state portion of the unfunded liability is \$29.3 billion.

**Background.** Proposition 2, which revised the state's BSA, was approved by the voters in November 2014. The measure changes the way the state sequesters money in reserves, as well as how it pays down debts and liabilities. Key components of Proposition 2 include:

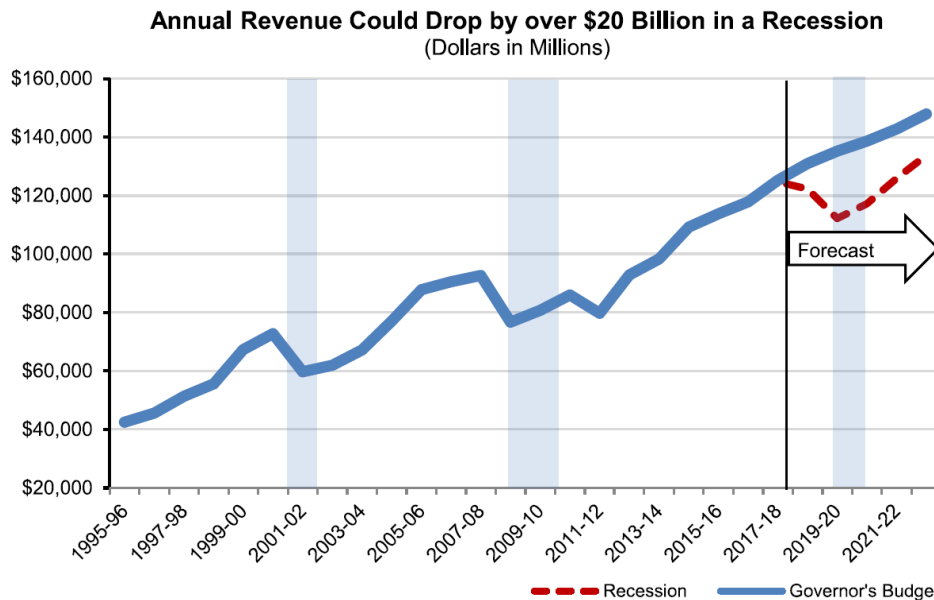
- Requires annual transfer of 1.5 percent of General Fund revenues to the BSA.
- Requires additional transfer of personal capital gains tax revenues exceeding eight percent of General Fund revenues to the BSA and, under certain conditions, a dedicated K–14 school reserve fund.
- Requires that half of the budget stabilization account revenues be used to repay state debts and unfunded liabilities.
- Allows limited use of funds in case of emergency or if there is a state budget deficit.
- Caps the BSA at 10 percent of General Fund revenues, directs remainder to infrastructure.

The SFEU is the state's discretionary reserve and is the difference between spending and available resources in any given fiscal year. There are two statutorily triggered reductions in the state's sales tax rate if balances in the SFEU reach a certain threshold. Under either statute, the state's sales tax rate would automatically decline by one-quarter cent for one calendar year. Under the first statute, the trigger would occur if the Director of Finance projects the SFEU to exceed about four percent of General Fund revenues (currently, about \$5.4 billion) in the prior

and current year. Under the second statute, the trigger would occur if 1) the General Fund reserve exceeds about three percent of revenues (currently, around \$4 billion) and 2) actual General Fund revenues between May 1st and September 30th exceed the Administration’s forecasted amounts.

The Governor points to the need for a healthy reserve to ensure the ongoing fiscal stability of the state. The Governor’s budget proposal points out that previous short periods of balanced budgets in the 2000s were followed by massive budget shortfalls. While each of these prior crises was preceded by a stock market crash, actions by the federal government could also easily overwhelm the fiscal capacity of the state. According to the Administration, the budget, now more than ever, demands caution and prudence. Among the uncertainties highlighted by the Administration is a:

- Possible Recession.** The Governor’s budget assumes the continued expansion of the economy. Yet, also notes that economic expansions do not last forever. In the post-war period, the average expansion has lasted about five years. By the end of the 2018-19 fiscal year, the expansion will have matched the longest in modern history. As shown in the figure below from the Governor’s budget proposal, a moderate recession will drop state revenues by over \$20 billion annually for several years.



**Legislative Analyst’s Office (LAO) Comments.** In its analysis the LAO notes that while the Governor’s proposed overall reserve level of \$15.7 billion is high historically for California, it is not particularly remarkable by national standards. The LAO points out that the Governor’s reserve proposal this year raises fundamental questions about the state’s current—and potential future—level of reserves. In particular: is the Legislature satisfied with the level of preparation for the next recession?

According to the LAO, the Governor’s proposed level is a reasonable minimum. However, they suggest that the Legislature consider future ideal levels of reserves in order to be fully prepared for the next downturn and point out that the Governor’s proposal, counterintuitively, makes building greater future reserves more difficult. This is because hitting the constitutional maximum level of 10 percent in the BSA creates an ongoing spending obligation of roughly \$1 billion per year on infrastructure (under the Administration’s current revenue estimates). As such, funds that would have been set aside in the BSA would be spent on infrastructure instead, lowering the amount of resources available for building more reserves. The following chart outlines options that the LAO suggests the Legislature consider.

<b>LAO Reserve Options for the Legislature to Consider</b>	
<b>Alternatives to Build More Reserves</b>	
Amend the Statutory SFEU Rules	The Legislature could revisit the statutory rules that automatically reduce the SFEU balance if it meets certain criteria. For example, the Legislature could increase the thresholds under which the rules are triggered. Then, the Legislature could leave the optional deposit funds in the SFEU.
Create Third Reserve Fund	The Legislature could create a third reserve fund and deposit the optional \$3.5 billion there instead of the BSA.
<b>Other Options</b>	
Prepaying Pension Costs	The Legislature could prepay \$3.5 billion of future years’ pension costs. Prepaying pension costs today would allow the state to reduce future constitutionally required pension costs by \$3.5 billion. This arrangement would free up \$3.5 billion of resources in any future year, when the funds would be needed to address a budget problem.
Appropriating Expenditures for Future Use	In the budget year, the state could set aside \$3.5 billion for future use, such as debt service or another specific use, earmarking the funds for when they will be needed in the future. Then, when the state faces a budget problem in the future, it could use the \$3.5 billion in set-aside funds to offset future costs, effectively freeing up \$3.5 billion for any other purpose.

**Staff Comment.** Given the length of the current recovery, California’s volatile tax structure, and the state’s experience during the last recession, the Governor’s reserve proposal appears

reasonable. However, in assessing the Governor's proposal, the LAO has raised important points for the Legislature to consider, such as how the proposal impacts future reserves and whether additional options should be explored.

Additionally, because, beginning in 2019-20, the Governor's proposal projects a little under \$1 billion in revenue in excess of BSA's ten percent of General Fund maximum that must be used for infrastructure, it is important that the Legislature understand how these funds can be used and to begin planning for their expenditure.

**Staff Recommendation.** Hold open.

**Vote:**

**0950 STATE TREASURER'S OFFICE**

**Department Overview.** The State Treasurer's Office (STO), a constitutionally-established office, provides banking services for state government with goals to minimize interest and service costs and to maximize yield on investments. The Treasurer is responsible for the custody of all monies and securities belonging to or held in trust by the state; investment of temporarily idle state monies; administration of the sale of state bonds, their redemption and interest payments; and payment of warrants or checks drawn by the State Controller and other state agencies. In addition, the Treasurer sits on numerous boards and commissions that deal with state, programs, investments and financing.

**Budget Overview.** The STO receives the great majority of its funding – roughly 75 percent – from reimbursements. The General Fund contribution to the office is roughly 15 percent of the total. As shown in the table below, position authority has remained relatively stable.

**State Treasurer's Office  
Program Expenditure  
(dollars in thousands)**

Program	Actual 2016-17	Estimated 2017-18	Proposed 2018-19
Investment Services	\$3,855	\$3,768	\$3,774
Centralized Treasury & Securities Management	12,848	14,606	14,628
Public Finance	15,701	17,692	10,749
Administration	16,163	6,201	6,559
Distributed Administration	-11,433	--	--
<b>Total Expenditures</b>	<b>\$37,134</b>	<b>\$42,267</b>	<b>\$35,710</b>

**State Treasurer's Office  
Position Authority  
(actual positions)**

Program	Actual 2016-17	Estimated 2017-18	Proposed 2018-19
Investment Services	16.6	17.0	17.0
Centralized Treasury & Securities Management	56.0	62.5	63.0
Public Finance	54.9	53.3	47.3
Administration	98.2	87.8	87.9
<b>Total Positions</b>	<b>225.7</b>	<b>220.6</b>	<b>215.2</b>



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**Issue 1: Infrastructure Support and Sustainability (BCP)**

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**Governor’s Proposal.** The 2017-18 budget includes a request from the STO of \$450,000 in General Fund in 2018-19 and \$400,000 annually thereafter to fund costs associated with providing IT support to STO and the various boards, commissions, and authorities (BCAs).

**Background.** The Information Technology Division (ITD) of STO is responsible for the development, maintenance and IT infrastructure that supports the STO's core business operations, in addition to the IT needs of the fourteen BCAs under the Treasurer's purview. ITD provides computing services to more than 400 state staff, and a variety of services to most state agencies, online banking for thousands of local government entities, in addition to electronic services for constituents.

STO distributes the costs of IT services, including infrastructure licensing and technical training to all of STO's primary business divisions and the BCAs. In their BY 2015-16 Spring Finance Letter (SFL), the STO requested expenditure authority from the BCAs to fund, with special funds, eleven new positions in the ITD for personnel supporting enterprise computing services and advanced application delivery. In the SFL, the STO noted that a technology-personnel true-up had not been undertaken since 2007. Ongoing license expenses, equipment upgrades and technical training accreted during this same decade, and were paid with the redirection of funds from other departmental budgeted expenses. The BY 2017-18 BCP requested resources to augment the IT security tools but did not fund any of the ongoing licensing, equipment upgrades, and technical training that the requested resources in this year’s BCP would be used on.

The STO argues that this current method of allocating costs to keep up with the emergence in complex technology is unsustainable—citing funding shortfalls of their current baseline budget associated with sustaining the infrastructure that has evolved over the last decade and compromises to planned expenditures in other business areas. The General Fund will resolve the shortfall by establishing an ongoing funding allotment and expenditure authority. Additionally, increasing the STO's budget will help the ITD maintain its infrastructure through software licensing renewals, upgrade/maintenance of hardware, and corresponding technical training.

**Legislative Analyst’s Office comments.** The LAO raises no specific concerns with the proposed activities or the amount of the requested augmentation. However, they recommend a modification of the proposal to fund the augmentation through the various funds associated with the BCAs and STO rather than exclusively from the General Fund. By modifying the proposal in this way, the costs are spread across entities receiving benefits.

**Staff Comments.** The STO indicated that the BCP will assist in a true-up of budgeted and actual expenditure on IT infrastructure as well as change the funding source for IT infrastructure. Instead of redirecting year-end funds from other sources, the BCP would instead draw these funds from the General Fund. However, the negative effects of the current practice on planned business expenditures are unclear. Moreover the growth in STO’s IT infrastructure expenditure over the last decade, owing to the increased complexity of IT infrastructure, and the potential continued increase in the future may occur. The STO indicated that, in this situation, they may

draw upon both the current funding source and proposed funding source to address shortfalls between budgeted and actual expenditures.

**Questions.**

- *Please describe the negative impacts of distributing IT service costs on planned and approved business expenditures. What is being sacrificed through the redirection of funding?*

**Staff Recommendation.** Hold open.

**0971 CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY**

The Governor's budget provides \$10.3 million for the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) in BY 2018-19, a net increase of \$4.5 million above the amount provided in BY 2017-18. This increase is almost entirely driven by a request for one-time reimbursement authority to continue administering the California Hub for Energy Efficiency Financing (CHEEF) pilots.

**Issue 1: Administration of California Hub for Energy Efficiency Financing Pilot Programs (BCP)**

**Governor's Proposal.** CAEATFA requests reimbursement and expenditure authority in the amount of \$8.2 million for FY 2018-19 and available through FY 2020-21 to appropriately carry out its functions as the administrator of the CHEEF pilots on behalf of the California Public Utilities Commission (PUC). This request will not impact the General Fund or any state special funds. This program is funded with ratepayer funds that have been approved and authorized by the PUC in a total amount of \$15.36 million.

**Background.** The CHEEF pilot programs are designed to encourage private lenders to develop financial products for energy efficiency projects. The pilots offer various forms of credit enhancements to provide additional security to participating financial institutions, attract private capital to energy efficiency finance, and expand consumer access to enhanced loan terms. CAEATFA was selected as the administrator of the CHEEF pilot programs which were approved for a two-year period by the Legislature and the PUC, and have been previously subject to review in the Senate Committee on Budget and Fiscal Review Subcommittee No. 2. The pilots were originally to be implemented through 2016-17.

The development and implementation of the pilots has taken longer than anticipated, largely due to (1) the short period initially established for the pilots (limited to two years for development and implementation 2) the complexity of the overall project and the time intensity related to the infrastructure development for both CAEATFA and participating stakeholders (e.g. lenders and IOUs); and depth of stakeholder engagement and coordination, and (3) staffing challenges which were not anticipated by CAEATFA at inception. CAEATFA and PUC staff began discussions on CAEATFA's resource needs to complete the pilots as they were originally designed - as well as challenges and opportunities of the pilots - over the summer of 2016. After consideration of public comment, in March 2017, the PUC released D 17-03-026 that approved several of CAEATFA's requested modifications to assist in streamlining and address challenges of the pilots. The PUC approved a decision which clarified that the 24-month term for the pilot programs should align with the enrollment of the first loan in that particular finance pilot.

This change—in combination with a longer than anticipated implementation schedule, unanticipated complexity, infrastructure development, stakeholder involvement, and staffing changes—requires extending the schedule for the pilots. Consistent with the budget request, the pilots will run through 2020-21.

**Legislative Analyst’s Office comments.** The LAO recommends that the Legislature modify the one-time \$8.2 million appropriation in 2018-19 by instead providing specific reimbursement authority over a three-year period as follows: \$3.6 million in 2018-19, \$3 million in 2019-20, and \$1.6 million in 2020-21. They also recommend that the Legislature add budget bill language that gives Department of Finance the ability to increase annual CAEATFA spending authority (but not to exceed the full budget authority requested over the three years), with a 30-day notification to the Joint Legislative Budget Committee (JLBC), if a change in the expected pilot timelines results in annual costs that exceed CAEATFA’s annual budget authority.

**Staff Comments.** The Legislature previously approved CHEEF pilot programs and the PUC committed long-term funding for pilot administration that enabled the authority to convert temporary positions to permanent positions, upgrade positions, and on-board staff. The upgrade to existing staffing is a reasonable step given the technical and specialized nature of the programs and issues related to personnel retention. The request for ratepayer funds would be consistent with prior actions and are required to be formally approved by the PUC through its standard governance process. However, the requested expenditure authority and anticipated expenditures in BY 2018-19 are not aligned. If the requested amount is approved, then the Legislature will have a reduced budget authority role if one or more of these pilot programs do not see completion—a relevant consideration given the history of timeline changes. It is important to balance the goals of the Legislature and CAEATFA as well as the difficulties and complexities—past and present—associated with developing and implementing these pilot programs.

**Staff Recommendation.** Modify the proposal to grant CAEATFA specific reimbursement authority over a three-year period as follows: \$3.6 million in 2018-19, \$3 million in 2019-20, and \$1.6 million in 2020-21. Adopt trailer bill language that gives DOF the ability to increase annual CAEATFA spending authority (but not to exceed the full budget authority requested over the three years), with a 30-day notification to the JLBC, if a change in the expected pilot timelines results in annual costs that exceed CAEATFA’s annual budget authority.

**Questions.**

- *What is CAEATFA’s response to the LAO’s recommendation? Are there downsides to the structure of the LAO’s proposal and if so, what are they?*

**Vote:**