*Senate Budget and Fiscal Review—Holly J. Mitchell, Chair*

# SUBCOMMITTEE NO. 4 Agenda

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

**Thursday, April 26, 2018**
**9:30 a.m. or upon adjournment of session**
**State Capitol - Room 2040**

Consultants: Joe Stephenshaw

**Items Proposed for Vote Only**



**Items Proposed for Discussion**



Public Comment

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# ISSUES PROPOSED FOR VOTE ONLY

## 8885 COMMISSION ON STATE MANDATES

The objective of the Commission on State Mandates (Commission) is to fairly and impartially hear matters filed by state and local governments and determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state consistent with Article XIII B, section 6 of the California Constitution.

The Commission is a quasi-judicial body consisting of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, a public member with experience in public finance, and two additional members from the categories of city council member, county supervisor, or school district governing board member, appointed by the Governor and approved by the Senate.

The Governor's budget includes $39.3 million ($37.1 million General Fund) and 13 positions for the Commission in 2018-19. The following table from the Governor's budget shows expenditures and positions for 2016-17 through 2018-19.

**3-YR EXPENDITURES AND POSITIONS**

| | | Positions | | | Expenditures | | |
|---|---|---|---|---|---|---|---|
| | | 2016-17 | 2017-18 | 2018-19 | 2016-17* | 2017-18* | 2018-19* |
| 6900 | Administration | 11.7 | 13.0 | 13.0 | $2,063 | $2,306 | $2,414 |
| 6905005 | Administrative License Suspension Mandates | - | - | - | 2,308 | 2,367 | 2,105 |
| 6905014 | Pesticide Use Reports | - | - | - | 37 | 50 | 65 |
| 6905040 | Local Agency Mandate Claims | - | - | - | 33,855 | 100,000 | 100,000 |
| 6905050 | Funded Mandates | - | - | - | - | -65,490 | -65,301 |
| **TOTALS, POSITIONS AND EXPENDITURES (All** | | **11.7** | **13.0** | **13.0** | **$38,263** | **$39,233** | **$39,283** |

Source: 2018 Governor's Budget (dollars in thousands)

### Issue 1: Funded and Suspended Mandates

**Governor's Proposal.** The proposed funding for non-education mandate payments to local governments is included in the Commission's budget. The Governor's mandate proposal is largely a continuation of the status quo in terms of mandates in effect (funded) and mandates not in effect (suspended). The budget proposes expenditures of $34.7 million related to funding non-education mandates. Most mandates funded in the budget concern public safety or property taxes. Funded mandates are listed in the following table.

**Mandate Funding in Governor's Budget**
**General Fund**
**(Dollars in Thousands)**

| Mandate Title | Amount |
|---|---|
| Accounting for Local Revenue Realignments | $ - |
| Allocation of Property Tax Revenues | 630 |
| California Public Records Act | - |
| Crime Victims' Domestic Violence Incident Reports | 164 |
| Custody of Minors-Child Abduction and Recovery | 12,964 |
| Domestic Violence Arrest Policies | 7,958 |
| Domestic Violence Arrests and Victims Assistance | 2,033 |
| Domestic Violence Treatment Services | 2,441 |
| Health Benefits for Survivors of Peace Officers and Firefighters | 2,416 |
| Local Agency Ethics | 1 |
| Medi-Cal Beneficiary Death Notices | 20 |
| Medi-Cal Eligibility of Juvenile Offenders | 3 |
| Peace Officer Personnel Records: Unfounded Complaints and Discovery | 743 |
| Post-Election Manual Tally | - |
| Rape Victim Counseling | 497 |
| Sexually Violent Predators | 3,561 |
| Sheriff Court-Security Services | - |
| State Authorized Risk Assessment Tool | 837 |
| Threats Against Peace Officers | - |
| Tuberculosis Control | 84 |
| Unitary Countywide Tax Rates | 347 |
| **Total** | **$34,699** |

Consistent with previous years, the budget includes the suspension of 56 mandates totaling $584.4 million.

**Staff Recommendation.** Approve as budgeted.

## 0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

### Issue 1: Cloud Support and Business Analysis

**Governor's Proposal.** The Governor's budget proposes $277,000 General Fund and two positions in fiscal year 2018-19 and ongoing to add one Systems Software Specialist III (Technical) and one Staff Information Systems Analyst to meet additional requirements associated with information technology (IT) growth.

**Background.** Since September 2013, the GO-Biz IT application portfolio has grown from one IT staff member and four supported applications to six IT staff members and sixteen supported applications. High-profile GO-Biz applications such as the California Competes Tax Credit Application and California Film and Tax Credit application have facilitated the award of hundreds of millions in tax credits to businesses and film and television production companies. The application process for both programs is completely online. Each new GO-Biz application is regularly updated and fourteen of the applications have been updated significantly with new functionality and content. Fourteen out of sixteen GO-Biz applications are public facing and required to be secure and available. Eleven out of the sixteen applications are currently hosted in the GO-Biz Amazon Web Services Virtual Private Cloud.

**Staff Recommendation.** Approve as budgeted.

## 1701 DEPARTMENT OF BUSINESS OVERSIGHT

### Issue 1: Information Technology Consulting Services Workload

**Governor's Proposal.** A spring finance letter proposes $132,000 in 2018-19 ($130,000 ongoing) in reimbursement authority and one permanent Information Technology Specialist I position to provide information technology support services to the Business, Consumer Services and Housing Agency (Agency), the Seismic Safety Commission (SSC), and the newly formed Cannabis Control Appeals Panel (CCAP).

**Background.** Agency has requested the Department of Business Oversight (DBO) begin providing dedicated IT services to itself, SSC, and CCAP. A dedicated network is required for each of the three entities to support approximately 40 employees. Agency, SSC, and CCAP have determined that it would be more efficient and cost effective to contract with the DBO for IT services than to hire their own IT staff or external contractors. If they do not contract with the DBO, each entity would need to hire, at minimum, one full-time position and contract with external consultants for any additional projects. The DBO has a complete array of expertise and would be more responsive to additional needs.

**Staff Recommendation.** Approve as budgeted.

# ISSUES PROPOSED FOR DISCUSSION AND VOTE

## 0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

The Governor's Office of Business and Economic Development (GO-Biz) provides a single point of contact for economic development, business assistance and job creation efforts. GO-Biz works with companies and organizations across the nation to market the benefits of doing business in California, recruit new businesses, retain businesses, and support private sector job growth. GO-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, economic growth, export promotion, permit assistance, innovation and entrepreneurship. GO-Biz consists of the following programs:

- **GO-Biz** serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, economic growth, and export promotion. This program makes recommendations to the Governor and the Legislature regarding policies, programs, and actions for statewide economic goals.

- **California Business Investment Services** serves employers, corporate executives, business owners, and site location consultants which are considering California for business investment and expansion. This program works with local, state, and federal partners in an effort to attract, retain, and expand businesses. The Innovation Hub (iHub) initiative is an effort to improve the state's national and global competitiveness by stimulating partnerships, economic development, and job creation around specific research clusters.

- **Office of the Small Business Advocate (OSBA)** serves as the principal advocate in the state on behalf of small businesses, including regarding legislation and administrative regulations that affect small business. The OSBA is responsible for disseminating information about programs and services provided by the state that benefit small businesses, and how small businesses can participate in these programs and services. The OSBA responds to issues from small businesses concerning the actions of state agencies, state laws and regulations adversely affecting those businesses. The OSBA maintains and distributes an annual list of persons serving as small business ombudsmen throughout state government.

- **California Film Commission (CFC)** provides significant financial assistance through its publically-funded tax credit program. The purpose of the CFC is to retain and increase motion picture production in the state. The CFC supports productions by issuing film permits for all state properties, administering the film and TV tax credit program, maintaining a location library, and offering production assistance on a wide variety of issues. CFC also works with cities and counties with the goal of creating 'film friendly" policies that are consistent state wide.

- **California Tourism Market Act** provides for the marketing of California through an assessment of businesses that benefit from travel and tourism. The objective of the Tourism Assessment Program is to identify potentially assessable businesses, assist companies with determining the appropriate amount of their self-assessment, and collect the fee.

- **California Infrastructure and Economic Development Bank (IBank)** was created to finance public infrastructure and private development that promotes economic growth. IBank has a broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage state and federal funds. IBank's current programs include the infrastructure state revolving fund, 501(c)(3) tax-exempt and taxable revenue bond program, industrial development revenue bond program, exempt facility revenue bond program, governmental bond program and the Clean Energy Finance Center (CEFC) and the Statewide Energy Efficiency Program under the CEFC.

- **Small Business Loan Guarantee Program (SBLGP)** promotes local economic development by providing guarantees for loans issued to small businesses from financial institutions, typically banks, which otherwise would not approve such term loans or lines of credit. The loan guarantee serves as a credit enhancement and an incentive for financial institutions to make loans to small businesses that otherwise would not be eligible for such financing.

- **California Welcome Centers** are visitor information centers that are accessible to and recognizable by tourists, and are designed to encourage tourism in California and provide benefits to the state economy. The objective of the California Welcome Center Program is to determine the locality of underserved travelers, designate a welcome center, and establish operating standards across the network.

The Governor's budget includes $27.5 million ($12.6 million General Fund) and 84.3 positions for GO-Biz in 2018-19. The following table from the Governor's budget shows the department's expenditures (and positions) for the prior, current and budget years.

**3-YR EXPENDITURES AND POSITIONS**

| | | Positions | | | Expenditures | | |
|---|---|---|---|---|---|---|---|
| | | 2016-17 | 2017-18 | 2018-19 | 2016-17* | 2017-18* | 2018-19* |
| 0220 | Go-Biz | 20.0 | 27.1 | 38.7 | $4,801 | $6,756 | $7,298 |
| 0225 | California Business Investment Services | 10.3 | 7.1 | 7.2 | 1,818 | 1,833 | 1,835 |
| 0230 | Office of the Small Business Advocate | 2.8 | 2.6 | 2.7 | 1,797 | 3,321 | 321 |
| 0235 | Infrastructure, Finance and Economic Development | 38.3 | 38.5 | 35.7 | 15,993 | 18,345 | 18,025 |
| **TOTALS, POSITIONS AND EXPENDITURES (All Programs)** | | **71.4** | **75.3** | **84.3** | **$24,409** | **$30,255** | **$27,479** |

Source: 2018 Governor's Budget (dollars in thousands)

## Issue 1: California Competes Tax Credit Program

**Governor's Proposal.** The Governor's budget proposes a five-year extension of the California Competes Tax Credit (CCTC) program, tax credit allocation authority of $180 million per year through the 2022-23 fiscal year, and $1.4 million General Fund per year through the 2022-23 fiscal year to maintain the 10 positions currently associated with administering the program. The proposal also requests to remove provisions of law that reserve a portion of the credit allocation for businesses with gross receipts of less than $2 million (small businesses).

The requested tax credit allocation authority of $180 million per fiscal year reflects a redirection of $20 million (from the historical $200 million annual allocation level) to provide funding for direct technical assistance to small businesses (discussed in a separate item).

According to the Administration, there are multiple reasons why the California Competes program should be extended. First, the value of the jobs and investment created under the program will continue to far exceed its requested funding. Second, it helps attract and retain high value employers to the state. Third, the program is more cost effective, accountable, and transparent than the former Enterprise Zone program which it replaced. Finally, it is a unique, flexible economic development tool that allows California to compete with other states that are actively recruiting employers to relocate or expand outside of California.

In its fourth full fiscal year of operation, GO-Biz had awarded $624.9 million in tax credits, in exchange for commitments from business to create a projected 83,412 new full-time jobs in California and invest $16.6 billion in the state. Additionally, these numbers represent only the direct impact of the California Competes program; they do not take into account the additional indirect, and induced economic impacts created by the vast amount of investment and employment facilitated by the program.

**Background.** Assembly Bill 93 (Committee on Budget), Chapter 69, Statutes of 2013, and Senate Bill 90 (Galgiani), Chapter 70, Statutes of 2013, are now commonly referred to as the Governor's Economic Development Initiative. AB 93 and SB 90 phased out the Enterprise Zone Program and replaced it with three new tax incentive programs. The first program of the initiative is a statewide, California Department of Tax and Fee Administration administered, partial sales and use tax exemption applicable to equipment procured by businesses engaged in manufacturing or biotechnology research and development. The second program is a geographically targeted hiring tax credit administered by the Franchise Tax Board. The third program is the CCTC, which is administered by GO-Biz.

The CCTC is a targeted tax credit program administered by GO-Biz and the Franchise Tax Board (FTB). The purpose of the CCTC is to attract, expand, and retain businesses in California. Business entities that apply for the credit are evaluated on the basis of number of employees; jobs created or retained; location of the company in the state; and magnitude of new investment. The tax credit packages are negotiated between the business and GO-Biz and then voted on by the GO-Biz committee, consisting of the director of GO-Biz, the director of the Department of Finance (DOF), the State Treasurer, and one appointee each from the Senate and the Assembly.

Under current law, the state may only make new California Competes tax credit awards through 2017-18.

Taxpayers may receive a maximum of 20 percent of the total amount of credits available for a particular year. In addition, 25 percent of the currently available credits must be provided to small businesses (companies with gross receipts of $2 million or less). Up to $780 million California Competes awards are available in total between 2013-14 and 2017-18. By fiscal year, the amount of credits that is allocated is up to $30 million in 2013-14, $150 million in 2014-15 and $200 million, per year, for years 2015-16 through 2017-18. These amounts may be reduced in order to ensure the total amount of tax reductions resulting from the program and two other tax preference programs (sales and use tax exemption for certain capital investments and new hiring tax credit) is no greater than $750 million in a fiscal year.

The DOF annually adjusts the amount available to reallocate (1) credits not awarded in a prior year and (2) "recaptured" credits. In 2016-17, for example, DOF allocated $243.4 million to California Competes because $39.9 million in tax credits were not awarded during the prior year and an additional $3.5 million had been recaptured.

Any business can apply for the CCTC. The credit is available statewide to all industries. However, while there are no geographic or sector-specific restrictions, the purpose of the CCTC is to attract and retain high-value employers in California in industries with high economic multipliers and that provide their employees good wages and benefits. According to the Administration, the program has succeeded in this mission, playing a significant role in the decision by many large companies to locate in California rather than out of state. California Competes awardees include companies such as, Tesla, Amazon, General Motors, Samsung, Proterra, BYD Motors, Hulu, and many others.

In administering this tax credit program, GO-Biz has several responsibilities that include: increasing awareness about the credit among the business community, accepting tax credit applications, evaluating applications, negotiating tax credit agreements, and monitoring agreement compliance for at least five years after the agreements are signed. The implementation of the program is defined based on the application process, evaluation process, negotiation process and committee process.

**Application Process.** During this stage of the program, CCTC staff engages in one-on-one contact with applicants and their designated representatives by providing assistance with computing and entering the required information. CCTC staff also confirms eligibility, explains regulations, recommends other resources and provides information about deadlines.

**Three Application Periods in 2017-18.** The first step is to submit an application. Businesses can learn about the application process from the GO-Biz website, e-mail notifications, the workshops, and other media. GO-Biz accepts applications during specified periods—three such application periods were scheduled for the 2017-18 fiscal year: July 24, 2017 to August 21, 2017; January 2, 2018 to January 22, 2018; and March 5, 2018 to March 26, 2018.

According the Legislative Analyst's Office, GO-Biz received 3,045 applications between the start of the program and June 2017. About 300 businesses, on average, apply for tax credits during each application period.

**Evaluation Process.** The evaluation process is two-phased. The initial phase calculates the cost-benefit ratio from the state's perspective, based on the credit request, aggregate employee compensation, and aggregate investment. The most competitive proposals move to the second evaluative phase. The second phase involves looking at specific selection criteria, including number of jobs, amount of investment, extent of unemployment and poverty in the project area, and opportunity for additional growth.

**Evaluation Phase 1: Applications Ranked.** In the first phase, GO-Biz scores each application using the information provided by each business about their hiring and investment plans. The purpose of this first phase is to weed out the businesses planning modest expansions relative to the amount of tax credit they are requesting. In this process, a business that requests a smaller tax credit—holding constant the proposed amount of hiring and investment—receives a higher score. Applicants with the highest scores move on to the second evaluation phase. The LAO noted that, the number of applications per period has remained stable while the amount of available tax credits has increased significantly. Over the most recent two years, more than 90 percent of the applications have moved on to the second evaluation phase, compared to fewer than 70 percent during the first two years of California Competes.

**Evaluation Phase 2: Additional Factors Considered.** State law gives GO-Biz broad authority to decide which businesses will receive tax credit awards. While the law requires GO-Biz to consider numerous factors, GO-Biz decides how much weight to give each factor in evaluating the applications. GO-Biz scores each application and then negotiates tax credit agreements with the highest scoring businesses on a case-by-case basis. The following table lists factors that GO-Biz considers when reviewing applications.

| Factors GO-Biz Will Consider When Reviewing Applications |
|---|
| • The number of jobs the business will create or retain in this state. |
| • The compensation paid or proposed to be paid by the business to its employees, including wages, benefits, and fringe benefits. |
| • The amount of investment in this state by the business. |
| • The extent of unemployment or poverty where the business is located. |
| • The incentives available to the business in this state, including incentives from the state, local government, and other entities. |
| • The incentives available to the business in other states. |
| • The duration of the business' proposed project and the duration the business commits to remain in this state. |
| • The overall economic impact in this state of the applicant's project or business. |

| |
|---|
| • The strategic importance of the business to the state, region, or locality. |
| • The opportunity for future growth and expansion in this state by the business. |
| • The extent to which the anticipated benefit to the state exceeds the projected benefit to the business from the tax credit. |

**Negotiation Process.** Contract negotiations require a significant amount of analysis and discussion between CCTC staff and the applicant. The intent is to reach specific agreements that create definitive milestones, explain agreement provisions, and tailor language specific to the project.

**Monitoring.** The inherent accountability in the California Competes program is due to the fact that the credit is prospective rather than retrospective, meaning that companies must apply for their tax credit in advance of creating the jobs and making investments, and must fulfill their promised hiring and investing before they may claim the benefit of the credit. In general, the credit agreements are for five years with an additional three years to maintain employment increases and salary levels. Since the credit agreement period may be up to eight years, multiple reviews may be conducted.

Some examples of acceptable records to show that a business is meeting milestones include: 1) employment and compensation levels - payroll reports and records to support hire dates, hours, or weeks worked; wages and salary levels for new employees and compensation paid, and 2) project investment - authorization for expenditures, invoices, deeds, contracts, lease/rental agreements etc.; project documents, timelines, capitalized costs, schedule of project costs etc.; summary analysis of changes in property, plant, and equipment; depreciation records; general ledger records.

**Legislative Analyst's Office (LAO) Comments.** In October of 2017, the LAO published a review of the CCTC focused on the experience to date in meeting the Legislature's goal for the program. The findings of the LAO report include:

- **Hiring and Investment Commitments Have Lessened.** The average contractual hiring and investment targets in these CCTC agreements have lessened over time. The LAO believes that the agreement terms have lessened because the number of applicants during each cycle has remained stable—at between 250 and 350 applicants—while the amount of available tax credits increased. Only $30 million was available in the first year of the program. DOF allocated $151 million to California Competes for 2014-15, $201 million for 2015-16, and $243 million for 2016-17. Since the credits are awarded on a competitive basis, it is not unreasonable that the hiring and investment targets could decline when there are fewer applicants competing for each tax credit dollar.

- **Tax Credits to Non-Tradable Businesses Are Windfall Benefits.** The CCTC is a windfall benefit for most businesses operating in the non-tradable sector of the economy. That is, the state provides a benefit to businesses without achieving the state's desired goal of increasing economic activity in the state.

- **Tax Credits to Non-Tradable Businesses Harm Economy.** The LAO notes that CCTC awarded to non-tradable businesses have negative economic impacts. First, nearly all economic growth that might be directly attributed to the tax credit was either already going to occur or came at the expense of other California businesses. That is, the credits did not achieve the goal set out for the program of increasing the overall level of economic activity in the state (jobs and/or investments). At the same time, the tax credits have "opportunity costs"—that is, they consume state resources that would have otherwise benefited the state's residents. For instance, the funds dedicated to the credits could have otherwise been used on other state spending priorities or on tax reductions to state residents or businesses. Finally, the credits create an uneven playing field, benefitting a handful of businesses while disadvantaging other businesses.

- **Many Non-Tradable Businesses Awarded Credits.** The LAO estimates that about 35 percent of the California Competes tax credit agreements were made with non-tradable businesses (the LAO attempted to distinguish between the primary industry of the business and the specific project when possible.) However, most of these tax credit awards were relatively small. As a result, the LAO estimates that only about 15 percent of the dollar value of the tax credits were awarded to such businesses.

- **Tradable Businesses Spur Economic Growth.** Many goods and services are tradable. Most manufactured goods, for example, can easily be shipped to another state or another country. Inexpensive and quick telecommunications and transportation also allow many services to also be tradable. A management consultant, for example, can live and work in California and have clients located anywhere in the world.

- **Credits to Tradable Businesses May Still Have Negative Impacts.** Providing credits to tradable businesses can still result in the same negative effects associated with credits awarded to non-tradable business. The simplest example is a business that had already planned to expand in California. Such a business has little to lose in applying for a CCTC. Moreover, there is no way to know with any certainty the actual plans of any business applying to the program. Accordingly, many credits to tradable businesses still produce windfalls and are, therefore, ineffective at attracting new investment and jobs. The state has also disadvantaged all other competing businesses that did not receive a credit.

The LAO has found that the Administration's proposal does not fully address problems inherent in California Competes. While the Administration's proposal attempts to address some of the problems the LAO raised about CCTC - for, example, including language that begins to address concerns about windfall benefits. However, the LAO suggests that the changes would not prevent windfall benefits or awards to businesses in the non-tradable sector of the economy. In addition, the changes would not prevent significant tax burden disparities among similarly situated taxpayers.

The LAO recommends that the Legislature reject the Administration's proposal to extend the CCTC. However, if the program is extended, the LAO suggests that the Legislature add language to law that clearly expresses the intent of the program as a tool to attract and retain employers in California. The LAO observes that some of the factors in law that GO-Biz considers in awarding tax credits create confusion about the intent of the program and allow GO-Biz to score non-tradable businesses highly in their evaluation process. In addition, the LAO recommends that to maximize the statewide economic benefits of the extended program, the program should be restricted to businesses that primarily serve markets outside the state.

**Staff Comment.** One of the underlying problems associated with traditional open-ended tax incentives is that the majority of the tax benefit goes to businesses that would have engaged in the desired behavior irrespective of the incentive program. The result is a loss in revenue with little or no associated impact on economic activity. The GO-Biz CCTC program attempts to eliminate or minimize this loss by targeting its incentives at companies on the margin.

As staff has indicated in the past, one way to measure success in this regard would be to examine companies that met the cost-benefit threshold (initial evaluation phase) and were among the finalists in selected criteria (second evaluation phase), but for one reason or another, were not selected as credit recipients. The legislature may also want to consider the following issues with respect to CCTC: 1) the degree to which GO-Biz has been able to channel investment into economically challenged areas of the state and into activities that provide opportunities to regional residents and 2) the extent to which Go-Biz is capable of assessing whether jobs and investment would either not be retained or not be created absent the existence of the credit, or whether an independent study should be required.

**Staff Recommendation.** Hold open.

## Issue 2: CA Small Business Development Technical Assistance Expansion Program

**Governor's Proposal.** The Governor's budget proposes $20 million General Fund for each year for the next five years. Of this, $17 million will go to establish and support the Small Business Development Technical Assistance Expansion Program and $3 million will go to the California Small Business Development Center program to assist in drawing down federal funds.

**Background.** According to the U.S. Small Business Administration's (SBA) "2017 California Small Business Profile," California has 3.8 million small businesses, which employ 6.8 million workers in the state—49.2 percent of the state's total workforce. Small businesses are also a key driver of California's exports. Over 75,000 small businesses engage in exporting, generating 43.4 percent of California's $158.3 billion in total state exports. SBA generally defines a small business as one that employs 500 or fewer employees for most manufacturing and mining industries or $7.5 million or less in average receipts for many non-manufacturing industries.

The federal government operates a number of programs that are designed to provide technical assistance to entrepreneurs and small businesses to enable and encourage their launch and growth. The technical assistance consists of one-on-one confidential consulting and low-cost training. The range of small businesses served varies according to the framework of each individual technical assistance program. These programs generally require a local cash match to be secured by the technical assistance centers in order to leverage the federal funding.

**Small Business Development Center Network.** The largest technical assistance program for small businesses in California is the Small Business Development Center (SBDC) Network, which is made up of five regional networks, each having an administrative hub and a network of SBDC sub-centers. SBDCs foster local and regional economic development by providing no-cost, extensive, one-on-one, long term professional business advising, low-cost training, and other specialized services to small business owners.

Since FY 2014-15, the Office of Small Business Advocate at GO-Biz has administered the state's Capital Infusion Program (CIP), which provides competitive grant funding to California's SBDC network. The CIP is aimed at helping SBDCs to expand their consulting services to small business owners and help them attain loans or investor capital, understand and resolve credit readiness issues, and develop funding strategies for business expansion or startup. The following chart summarizes metrics generated from operation of the CIP in recent years:

| Fiscal Year | State Dollars Committed | Capital Infusion Generated | Clients Served |
|---|---|---|---|
| **2014-15** | $2,000,000 | $202,645,465 | 10,053 |
| **2015-16** | $2,000,000 | $173,856,832 | 10,251 |
| **2016-17** | $1,500,000 | $263,314,473 | 11,728 |
| **2017-18** | $3,000,000 | TBD | TBD |

GO-Biz requests $3 million for the California SBDC network to assist in drawing down federal funds, which will allow the SBDCs to focus on access to capital for small businesses. GO-Biz will distribute the $3 million in funding to the five SBDC hub regions based on each region's share of the state's total population.

**Small Business Development Technical Assistance Expansion Program.** This request also includes $17 million and proposed trailer bill language to establish the California Small Business Development Technical Assistance Expansion Program, which will be a competitive grant program to support an expansion in services provided by federal small business technical assistance programs to small businesses and pre-venture entrepreneurs. The purpose of the program is to expand federal small business technical assistance programs into new and/or underserved small business segments, with a focus on women, minority, and veteran-owned businesses and businesses in low-wealth, underserved, rural, and disaster-impacted communities. In addition to the SBDC program, the proposal identifies several other federal technical assistance programs:

| Program | Administering Federal Agency | Federal Funding Available to California | Focus |
|---|---|---|---|
| Small Business Development Center | U.S Small Business Administration | $12,824,892 | One-on-one, technical consulting for small business owners |
| Women's Business Centers | U.S. Small Business Administration | $1,950,000 | Technical assistance for new or established women entrepreneurs |
| Veteran's Business Outreach Centers | U.S. Small Business Administration | $300,000 | Counseling and training for veteran and service-disabled veteran small business owners |
| Minority Business Development Centers | U.S. Department of Commerce, Minority Business Development Agency | $1,253,000 | Facilitating contracts and financing for minority owned small businesses |
| Export Centers | U.S. Department of Commerce, Minority Business Development Agency | $250,000 | Technical assistance and business development services for minority owned small business |
| Manufacturing Extension Program | U.S. Department of Commerce, National Institute of Standards and Technology | $14,046,000 | Consulting services for small manufacturing businesses |
| Procurement Technical Assistance Center | U.S Department of Defense, Defense Logistics Agency | $1,950,000 | Training and assistance for small businesses related to contracting with the Department of Defense |

This funding will focus on the expansion of no-cost, one-on-one consulting and low-cost training to small businesses in the areas of capital access, commercialization, business plans and strategy, export assistance, sales, operations, financial management, marketing, cybersecurity, manufacturing assistance, emergency preparedness, business continuity and disaster recovery, and increased productivity and innovation. These funds will not replace existing local cash match dollars.

The grant program will require applicants to have an existing contract with a federal funding partner and demonstrate the ability to draw down a substantial amount of the federal funds available to them. Awardees will be required to submit quarterly invoices and metric reports in addition to an annual report on program outcomes. Quarterly report outcomes will be compared to the milestones from the original grant application. Significant deviations from these milestones will need to be addressed by the awardee through an action plan. If the awardee does not sufficiently address any significant deviations from the milestones in its grant award agreement, GO-Biz may withhold the remaining grant funds. Should this occur, GO-Biz may either redirect those grant funds to a new awardee or to an existing awardee that has demonstrated success.

GO-Biz currently has three positions supporting small business assistance and does not plan to increase its staff to support these programs.

**Legislative Analyst Office's Comments.** The Legislative Analyst's Office (LAO) has noted that the Governor's proposal addresses some of the concerns they raised with the small business component of the California Competes Tax Credit program.

**Staff Comments.** Historically, state funding to the SBDC network has been erratic and inconsistent. After receiving no funding from the General Fund from 2004 to 2010, the SBDC network received one-time infusions of $6 million in 2011, $2 million in 2014 and 2015, $1.5 million in 2016, and $3 million 2017. This proposal will help stabilize support for the program, allowing the network to more reliably draw down a portion of federal funding.

**Staff Recommendation.** Approve as budgeted.

# 1701 Department of Business Oversight

The Department of Business Oversight (DBO) serves Californians by effectively overseeing financial service providers, enforcing laws and regulations, promoting fair and honest business practices, enhancing consumer awareness, and protecting consumers by preventing potential marketplace risks, fraud, and abuse.

The Governor's budget includes $97.8 million from special funds (State Corporations Fund, Financial Institutions Fund, Credit Union Fund, and Local Agency Deposit Fund) and 584 positions for DBO in 2018-19. The following table from the Governor's budget shows expenditures and positions for the prior, current and budget years.

**3-YR EXPENDITURES AND POSITIONS**

| | | Positions | | | Expenditures | | |
|---|---|---|---|---|---|---|---|
| | | 2016-17 | 2017-18 | 2018-19 | 2016-17* | 2017-18* | 2018-19* |
| 1510 | Investment Program | 126.1 | 167.4 | 177.3 | $24,842 | $29,973 | $30,901 |
| 1515 | Lender-Fiduciary Program | 117.9 | 133.7 | 134.7 | 21,764 | 23,651 | 23,333 |
| 1520 | Licensing and Supervision of Banks and Trust Companies | 140.0 | 165.0 | 171.0 | 23,531 | 27,634 | 27,799 |
| 1525 | Money Transmitters | 26.0 | 31.1 | 31.3 | 3,912 | 4,302 | 4,336 |
| 1530 | Supervision of California Business and Industrial Development Corporations | - | - | - | 16 | - | - |
| 1540 | Industrial Banks | - | - | - | 377 | - | - |
| 1545 | Administration of Local Agency Security | 1.3 | 1.7 | 1.8 | 501 | 556 | 559 |
| 1550 | Credit Unions | 57.5 | 67.5 | 67.9 | 9,049 | 10,751 | 10,825 |
| 9900100 | Administration | 107.6 | - | - | 12,971 | - | - |
| 9900200 | Administration - Distributed | - | - | - | -12,971 | - | - |
| **TOTALS, POSITIONS AND EXPENDITURES (All Programs)** | | **576.4** | **566.4** | **584.0** | **$83,992** | **$96,867** | **$97,753** |

Source: 2018 Governor's Budget (dollars in thousands)

## Issue 1: Information Technology Office – Workload Growth and Risk Mitigation Initiative

**Governor's Proposal.** The Governor's budget includes $613,000 in Special Funds in 2018-19 ($577,000 ongoing) and four positions to begin to eliminate backlogs and fill critical resource and skill gaps in the Information Technology Office (ITO) organization. These resources will enable DBO to increase the capacity and competency of the ITO to a level where it can more effectively and efficiently maintain and support DBO's technology systems critical to serving California consumers in its regulatory oversight of California financial service providers.

**Background.** In 2016-17, DBO submitted a Budget Change Proposal (BCP) to fund seven permanent positions for the ITO for two years as part of a plan to move away from an IT service contract that was in place to support the day-to-day maintenance of the DOCQNET (self-service portal) system through June 2018. The DOCQNET system allows DBO to conduct its necessary and growing regulatory functions, which include revenue collection, enforcement actions, and licensee examinations and licensing. The DOCQNET system is designed to allow users to process license applications, complaints, and forms electronically, thus reducing the state's paper footprint.

The 2016-17 BCP was approved on the basis that the cost of procuring an IT contractor beyond June 2018 could be avoided if state IT staff were able to provide full DOCQNET support instead. The DBO is now well positioned to avoid the cost of the contractor once the contract expires in July 2018. As planned, the contract cost savings will be redirected to cover the ongoing cost of the seven positions. The seven positions consist of two programmers, two customer support specialists (help desk), one database administrator, one network support specialist, and one project manager, all of which who provide support for the DOCQNET system.

However, there are new issues, gaps and backlogs that must be addressed to ensure adequate support for the DBO IT systems. IT contractors have been used at DBO since its creation in July 2013, and have provided over 80 percent of IT maintenance and support of DBO systems to date. The use of IT contractors has been driven by the lack of state skills, expertise and resource capacity needed to maintain and support all DBO systems effectively and efficiently on an ongoing basis. The DBO ITO resource ratio, compared to the overall size of DBO, is far less than similar IT organizations across the state. Typical IT organizations represent approximately 10-15 percent of the workforce while the DBO IT ratio is currently only 6.2 percent. Adding four additional positions would increase the DBO IT ratio to 6.8 percent of the DBO's overall workforce.

**Legislative Analyst's Office Comments.** The Legislative Analyst's Office has not expressed concern with this proposal.

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

**Staff Recommendation.** Approve as budgeted.

## Issue 2: Student Loan Servicing Act Implementation

**Governor's Proposal.** The Governor's budget proposes $737,000 from the Financial Institutions Fund ($690,000 ongoing) and five permanent positions; two positions to perform examinations of Student Loan Servicing Office licensees and three positions to handle consumer complaints, as required by AB 2251 (Stone), Chapter 824, Statutes of 2016.

**Background.** Current law requires DBO to create a new Student Loan Servicing Office to license and regulate student loan servicers and to enforce any violation of the Student Loan Servicing Act. The DBO also is required to examine the affairs of each licensee at least once every 36 months for compliance with the Student Loan Servicing Act.

In 2017-18, DBO was approved for three permanent positions to start up and administer the Student Loan Servicing Office. Additionally, DBO intends to begin receiving and approving licensee applications in January 2018 so that licensees can begin operations on July 1, 2018.

In 2018-19, the Financial Institutions Manager and the two Senior Financial Institutions Examiners will conduct initial exams on licensees to obtain an understanding of their operations, determine their compliance with California law and introduce the DBO's regulatory expectations. Because the majority of anticipated licensees are located outside California, exams will require extensive out-of-state travel. The DBO expects licensees to reimburse the DBO for examination time and travel costs incurred. In subsequent years, the examiners are expected to conduct initial exams on all new loan servicer licensees. As more companies enter the student loan refinance market, additional private loan servicer licensees are expected.

Beginning in 2018-19, to ensure all licensees are examined at least once every 36 months, the examiners will conduct 12 full scope exams annually. Because over 93 percent of the $1.34 trillion in student loan debt is held by the federal government, exams of the nine federal loan servicers require significantly more time and resources than the smaller private loan servicers.

When the Student Loan Servicing Office opens, California borrowers are expected to file their complaints with DBO, and DBO must be prepared to address these complaints.

**Legislative Analyst's Office Comments.** The Legislative Analyst's Office has not expressed concern with this proposal.

**Staff Comments.** The requested resources are consistent with the 2016 analysis of AB 2251, which sized the program at 11 positions.

**Staff Recommendation.** Approve as budgeted.

# 9210 Local Government Financing

The state provides general-purpose revenue to counties, cities, and special districts when special circumstances occur. The Local Government Financing program includes those payments to local governments where the funds may be used for any general government purpose as well as funds for one-time, designated purposes.

The Governor's budget includes $28.9 million General Fund for the Local Government Financing program in 2018-19. The following table from the Governor's budget shows expenditures for the prior, current and budget years.

| 3-YR EXPENDITURES AND POSITIONS | | Positions | | | Expenditures | | |
|---|---|---|---|---|---|---|---|
| | | 2016-17 | 2017-18 | 2018-19 | 2016-17* | 2017-18* | 2018-19* |
| 7540 | Aid to Local Government | - | - | - | $27,299 | $138 | $23,917 |
| 7555 | Property Tax Assessors' Partnership Agreement Program | - | - | - | 4,409 | - | - |
| 7575 | County Assessors' Grant Program | - | - | - | - | - | 5,000 |
| **TOTALS, POSITIONS AND EXPENDITURES (All Programs)** | | **-** | **-** | **-** | **$31,708** | **$138** | **$28,917** |

Source: 2018 Governor's Budget (dollars in thousands)

## Issue 1: County Assessors' Grant Program

**Governor's Proposal.** The Governor's budget proposes $5 million and trailer bill language for a State Supplementation for the County Assessors Program (SSCAP).

**Background.** The Governor's budget proposes trailer bill language to create a new program that would provide county assessors with funding to hire new assessment staff and improve IT systems to allow assessors to more accurately value existing property and expeditiously enroll new property, and thereby increase countywide assessed values. Higher assessed values mean higher property tax revenue for K-14 schools, which offsets the state's Proposition 98 General Fund obligation.

Program details include:

- Three-year pilot program begins 7/1/18 and ends 6/30/21.
- Administered by Department of Finance (DOF).
- $5 million appropriation proposed in 2018-19 Governor's budget. Future funding subject to Budget Act appropriations.
- No single county can receive more than 15 percent of the annual appropriation ($750,000).
- Only one application period. Participants will continue in SSCAP until it terminates.
- County match is $1 for each $2 in SSCAP funds received.

Previously, the state provided assessors' offices with forgivable General Fund loans beginning in 1995, with forgiveness provided upon receipt of information that indicated the assessors generated additional property tax revenue for K-14 schools in an amount at least equal to their loan.

In 2002, that program became the Property Tax Administration Grant Program under which each assessor received a statutorily fixed share of the annual $60 million appropriation. The Grant Program was defunded in the 2005 Budget Act as a cost-saving measure.

Legislation enacted concurrent with the 2014 Budget Act established the State‑County Assessors' Partnership Agreement Program (SCAPA) on a three-year basis, to be administered by DOF. SCAPA provided competitively selected county assessors' offices with grants to enhance assessment activities – the goal being to generate more property tax revenue for K-14 schools.

Initial SCAPA funding was $7.5 million per year over a three-year period. Because several participants requested less funding than they were eligible to receive, annual expenditures were as follows:

| **SCAPA Expenditures By Year** | | |
|---|---|---|
| 2014-15 | 2015-16 | 2016-17 |
| $4,389,000 | $4,342,750 | $4,407,750 |

The table below shows the additional value that assessors reported was added to the property tax rolls during SCAPA:

**Roll Value Increase 2014-15 through 2016-17**

| | |
|---|---|
| New Construction | $20,315,601,561 |
| Change in Ownership | $8,980,482,247 |
| Supplemental Assessments | $15,685,465,728 |
| Property Modifications | $3,775,197,014 |
| Escaped Assessments | $10,257,988,112 |
| Proposition 8 Adjustments | $6,181,778,543 |
| Assessment Appeals | $3,883,029,614 |
| Audits | $35,225,864 |
| Previously Unassessed | $528,329,880 |
| **Total** | **$69,643,098,563** |

The calculated cumulative return-on-investment for school and county office of education revenue was $31.74 for each SCAPA dollar spent in 2014-15, $24.80 in 2015-16, and $26.74 in 2016-17.

DOF notes SCAPA's estimated returns-on-investment may have been made clearer by a reporting structure that allowed reviewers to measure roll value increases on a FTE basis, as measured against a pre-SCAPA base year. The SSCAP proposed in the 2018-19 Governor's budget builds upon the previous SCAPA program and modifies the reporting structure to better evaluate returns-on-investment.

**Legislative Analyst's Office Comments.** The Legislative Analyst's Office (LAO) found that while it is reasonable to consider funding for county assessors, measuring the effect of funding on property tax collections is difficult because it is not possible to know how much revenue would have been collected in the absence of additional funding. Additionally, the LAO points out a that counties may charge each city and special district an amount proportionate to its share of countywide property tax revenues to cover administrative costs, however, counties are not allowed to recoup administration costs from schools.

The LAO recommends that the Legislature consider alternatives, such as making the $15 million in funding proposed by the Administration ($5 million per year over the next three years) available for grants to county assessors to help cover one-time costs of technology upgrades. The LAO suggests that the Legislature could create a more level playing field for counties by setting the grants equal to the schools' share of the cost of the upgrades. Doing so would mean that each county would pay a share of costs for the upgrade that is proportionate to their share of any new revenue generated from the upgrade. Compared to paying for both staff and technology, focusing on technology would allow the funding to be spread across more counties. In addition, technology upgrades are more likely to have a lasting impact on assessor productivity compared to limited-term staff whose effect on output generally ends when they leave the office.

**Staff Comments.** Staff notes that the California Assessors' Association is in support of this proposal, however, has also submitted technical recommendations for consideration as well as recommendation to increase the total grant amount and the maximum that a county can apply for.

**Staff Recommendation.** Approve as budgeted.

## Issue 2: Property Tax Backfill

**Governor's Proposal.** The Governor's budget includes $23.7 million General Fund to backfill the property tax revenue losses that cities, counties, and special districts will incur in 2017-18 and 2018-19 due to the October 2017 wildfires in Northern California.

**Background.** This funding estimate will be adjusted as part of the May Revision as more information becomes available from county assessors. This adjustment also will include backfills for the property tax revenue losses incurred by cities, counties, and special districts in 2017-18 and 2018-19 due to the Southern California wildfires that started in December 2017 and the January 2018 mudslides.

**Staff Recommendation.** Hold open.