Members:
NOREEN EVANS
DOUG LA MALFA

California State Senate

CONSULTANTS:
BRIAN ANNIS
BRADY VAN ENGELEN

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

SUBCOMMITTEE #4 ON
STATE ADMINISTRATION AND
GENERAL GOVERNMENT

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Gloria Negrete McLeod, Chair

UPDATE ON SAFE ACT IMPLEMENTATION

BACKGROUND PAPER

JOINT INFORMATIONAL HEARING OF THE

SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE
Juan Vargas, Chair

and the

SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT
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UPDATE ON SAFE ACT IMPLEMENTATION

JOINT INFORMATIONAL HEARING OF THE

SENATE COMMITTEE ON BANKING & FINANCIAL INSTITUTIONS AND THE SENATE BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT

Senators Juan Vargas and Gloria Negrete McLeod, Chairs

Wednesday, March 7, 2012
State Capitol, Room 112
1:30 PM – 3:00 PM

I. Welcome and Opening Remarks – *Chairs McLeod and Vargas*

II. Update on SAFE Act Implementation

   A. Colleen Monahan, Louisa Broudy, and Michele Bond, Deputy Commissioners, Department of Corporations

   B. Tom Pool and Steve Ellis, Assistant Commissioners, Department of Real Estate

III. Public Comment

IV. Closing Remarks and Next Steps – *Chairs Vargas and McLeod*

UPDATE ON SAFE ACT IMPLEMENTATION IN CALIFORNIA
JOINT INFORMATIONAL HEARING OF THE SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE AND THE SENATE BUDGET AND FISCAL REVIEW SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION AND GENERAL GOVERNMENT

BACKGROUND PAPER

Introduction: The foreclosure crisis currently gripping California had many causes, and has, understandably, generated considerable state and federal action intended to prevent anything similar from happening again. One of the causes of the current crisis, which has generated a great deal of congressional, legislative, and regulatory action, is mortgage loan origination (i.e., the act of taking a mortgage loan application from a borrower and offering or negotiating the terms of a mortgage with that borrower). The logic behind action in this area is based on the premise that every individual who originates a mortgage loan should meet a minimum set of qualifications, should be trained in responsible mortgage loan origination practices, and should be accountable for their actions toward borrowers. Such standards were not in place during the irrationally exuberant 2004 through 2007 time period, and might have helped stem the tide of failed mortgage loans if they had been.

To be clear, mortgage loan origination is only one part of a much larger set of causes addressed by legislators and regulators since the nation's mortgage market imploded. Other key components of the crisis that have resulted in state and federal action include mortgage loan underwriting, real property valuation practices, mortgage loan securitization practices, and mortgage loan servicing practices, among many others. However, mortgage loan origination is one of the few causes that helped contribute to the mortgage crisis, which remains regulated primarily at the state level. It is because mortgage loan origination is regulated primarily by states that a considerable amount of California's recent regulatory focus has centered on the licensing and regulation of mortgage loan originators.

On Wednesday, March 7, 2012, the California Senate Banking and Financial Institutions Committee and the California Senate Budget and Fiscal Review Subcommittee Number 4 on State Administration and General Government will review the status of California's implementation of a comprehensive mortgage loan originator licensing system enacted in 2009. Both committees will ask the two departments that have been responsible for implementing our state's mortgage loan originator licensing laws to review their actions to date. How many licenses have been issued? How many disciplinary actions have been brought? What new information has been collected from licensees? What implementation challenges have been encountered? What staffing issues have arisen?

By jointly reviewing these topics, both the budget subcommittee and the policy committee with jurisdiction over the mortgage loan activities of these departments can work together to ensure that the California public receives the protections intended by the Legislature, when it enacted California's mortgage loan originator licensing scheme.

Background: On July 30, 2008, President George W. Bush signed the Housing and Economic Recovery Act of 2008, whose provisions included the Secure and Fair Enforcement for Mortgage Licensing Act (the SAFE Act). The SAFE Act gave each of the 50 states a choice – either a state could enact a law requiring individual mortgage loan originators doing business in that state to obtain SAFE Act mortgage loan originator licenses through a nationwide organization called the Nationwide Mortgage Licensing System and Registry (NMLSR); or, the state could fail to act. Any state which failed to act by July 30, 2009, or which acted to comply with the SAFE Act in a manner deemed unacceptable by the United States Department of Housing and Urban Development (HUD), risked intervention by HUD. The SAFE Act authorized HUD to establish and maintain a SAFE Act-compliant mortgage loan originator licensing scheme in any state that voluntarily failed to do so, an act that would, if undertaken by HUD, shift regulatory jurisdiction over the mortgage loan originators licensed in that state from the state to HUD. California opted to enact SAFE Act-compliant legislation, in order to retain its authority to regulate mortgage loan originators operating in California. That implementing legislation was contained in SB 36 (Calderon), Chapter 160, Statutes of 2009.

What Does the Federal SAFE Act Require? The SAFE Act defines the term "mortgage loan originator" as one who takes a residential mortgage loan application or offers or negotiates terms of a residential mortgage loan for compensation or gain. Administrative and/or clerical employees are not included within the definition. Generally speaking, this term includes both mortgage brokers and loan officers.

The SAFE Act creates a distinction between mortgage loan originators who are employed by depository institutions or subsidiaries of depository institutions, and all other mortgage loan originators. Under the SAFE Act, mortgage loan originators who are *not* employed by a depository institution or a subsidiary of a depository institution must be *both licensed* by their state *and registered* through NMLSR[1]. License applicants must undergo background checks, submit to credit checks, complete pre-licensing education courses approved by NMLSR, pass national and state-specific pre-licensing examinations developed by NMLSR, meet specified personal character requirements specified in the SAFE Act, and pay specified licensing and license processing fees through NMLSR. Once licensed, mortgage loan originators must complete annual continuing education courses approved by NMLSR. Mortgage loan originators must also submit quarterly mortgage loan origination activity reports and annual reports of financial condition to NMLSR (see subsequent section for more detail regarding these reports).

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[11][1] The NMLSR is a web-based application run by the State Regulatory Registry LLC (SRR), a wholly owned subsidiary of the Conference of State Bank Supervisors. According to the SRR's most recent annual report (http://www.csbs.org/mortgage/Documents/2010%20SRR%20Annual%20Report.pdf), the NMLSR enables state-licensed mortgage lenders, brokers and loan originators to apply for, amend, update or renew licenses online using a single set of uniform applications, and allows federally regulated depository institutions and subsidiaries to register mortgage loan originators, as required by federal banking agencies. For all intents and purposes, the NMLSR is the clearinghouse through which all SAFE Act regulatory filings must be made, and through which all SAFE Act regulatory fees must be paid. States may *not* process SAFE Act applications through their own state-specific systems.

In California, two departments – the Department of Real Estate (DRE) and the Department of Corporations (DOC) – have jurisdiction over laws that authorize mortgage loan origination activity which requires licensing pursuant to the SAFE Act.

The SAFE Act treats mortgage loan originators who are employed by depository institutions very differently than it treats mortgage loan originators who are employed by non-depositories. In lieu of licensing, the SAFE Act requires mortgage loan originators who are employed by depository institutions or their subsidiaries to *register* on NMLSR, using rules established by the Federal Financial Institutions Examination Council (FFIEC). Registrants must undergo background checks, but are not required to submit to credit checks, nor comply with the education and testing requirements that apply to mortgage loan originators who are required to be licensed under the Act. Because the SAFE Act does not require registrants to register with state licensing entities, California's Department of Financial Institutions (DFI) does not process registration applications submitted by employees of state-licensed depository institutions. Those activities are coordinated entirely by the NMLSR.

How Does California's SAFE Act Law (SB 36) Work?

<u>Real Estate Law Practices and Procedures:</u> Under the provisions of California law, real estate licensees who wish to act as mortgage loan originators must obtain a license endorsement from DRE. Thus, if one wishes to originate mortgages pursuant to the Real Estate Law, one must first obtain a real estate license. Only with that real estate license may an individual apply for a license endorsement to act as a mortgage loan originator. The license endorsement is only available to real estate licensees who comply with the background check and education requirements of the SAFE Act, and who meet the SAFE Act's personal character requirements. Consistent with the SAFE Act, SB 36 requires mortgage loan originators to renew their license endorsements annually.

DRE offers real estate licenses to both individuals and corporations. In order to process SAFE Act mortgage loan originator license applications through the NMLSR, DRE has had to establish three different categories of mortgage loan originators – 1) individual, 2) real estate broker -- sole proprietor company, and 3) real estate corporation company.

Technically, the SAFE Act requires individual (rather than corporate) licensing. Thus, real estate corporation companies do not technically obtain SAFE Act licenses. However, real estate corporations (both sole proprietors and corporation companies) are required to identify themselves as such on the NMLSR. They are also required to ensure that all of their real estate licensee employees who engage in mortgage loan origination activities obtain mortgage loan originator license endorsements. It is illegal for a real estate licensee to originate a residential mortgage without first obtaining a mortgage loan originator license endorsement.

The license fees and NMLSR processing fees that must be paid by each of the different types of real estate licensees are different.

- Individual mortgage loan originators (whether real estate salespersons or real estate brokers) must pay $300 to obtain a mortgage loan originator license endorsement, plus a $30 NMLSR processing fee. Both of these fees are also assessed annually, upon license endorsement renewal. These fees are in addition to the costs for education, testing, credit reporting, and fingerprinting, which are also required of mortgage loan originator applicants and licensees.

- In addition to the fees described above, any real estate broker who is a sole proprietor must pay a $100 NMLS processing fee to register their company on the NMSLR. Thus, an individual real estate broker who originates residential mortgage loans and who is a sole proprietor must pay $430 annually ($300 plus $30 for their individual mortgage loan originator license endorsement, plus $100 to register their sole proprietorship on the NMSLR).

- Real estate corporation companies pay a different amount than sole proprietorships. Each real estate corporation company that originates residential mortgage loans must have a designated officer who holds a mortgage loan originator license endorsement ($300 plus $30) and must pay $300 to register their company on the NMLSR, plus a $100 NMLS processing fee. Thus, a real estate corporation company that originates residential mortgage loans must pay at least $700 annually ($300 plus $30 for the license endorsement for the designated officer, plus $400 to register their corporation on the NMLSR).

Mortgage loan originator license endorsements expire on December 31st of each year, and must be renewed, effective January 1st of the following year.

<u>California Finance Lenders Law (CFLL) and California Residential Mortgage Lending Act (CRMLA) Practices and Procedures:</u> Unlike the Real Estate Law, which licenses both individuals and corporations, the CFLL and CRMLA offered lending licenses only to qualified companies (not individuals) prior to enactment of SB 36. Because the SAFE Act requires that individuals hold mortgage loan originator licenses, SB 36 amended the CFLL and CRMLA to authorize the issuance of mortgage loan originator licenses to individual employees of companies holding CFLL and CRMLA licenses.

Under California law, every employee of a licensed finance lender (CFL) or licensed residential mortgage lender (RML), who engages in mortgage loan origination activities, is required to obtain a mortgage loan originator license. That license is only available to employees who comply with the background check, education, and testing requirements of the SAFE Act, submit to a credit check, meet the SAFE Act's personal character requirements, and pay the appropriate license and processing fees (though, in practice, many CFLs and RMLs pay the license and processing fees on behalf of their employees). Under California law, a mortgage loan originator license is separate and apart from a CFLL or CRMLA license. Every licensed CFL and RML must ensure that their mortgage loan originator employees hold SAFE Act-compliant mortgage loan originator licenses. It is a violation of law for a CFL or an RML to make a mortgage loan that was originated by an individual who does not hold a mortgage loan originator license.

SAFE Act license fees imposed on mortgage loan originators licensed through DOC are similar to those imposed on mortgage loan originators licensed through DRE. Individual mortgage loan originators must pay $300 to obtain (or renew) a mortgage loan originator license, plus a $30 annual processing fee. These fees are in addition to the costs incurred to pay for required education, testing, credit reporting, and fingerprinting. Each CFL and RML company must pay $100 annually to register through the NMLSR, plus $20 annually to register each branch office location.

Pursuant to the SAFE Act, mortgage loan originator licenses expire on December 31st of each year, and must be renewed, effective January 1st of the following year.

<u>Banking Law and Credit Union Law:</u> SB 36 did not amend California's Banking or Credit Union Laws. Instead, California's DFI has directed its bank and credit union licensees to follow the SAFE Act regulations issued by the FFIEC. DFI examines its licensees for compliance with those regulations during its periodic regulatory examinations.

SAFE Act Reporting Requirements: The SAFE Act requires licensed mortgage loan originators to submit two different types of periodic reports through the NMLSR – a quarterly "call" report, which provides a snapshot of the volume and nature of residential mortgage loan origination activity conducted during each calendar quarter by each firm that employs licensed mortgage loan originators, and an annual "report of financial condition," which provides information about the financial condition of those firms. These reports are required to be filed at the company level, unless a mortgage loan originator licensee is a sole proprietor.

So, for example, if XYZ Mortgage Company is licensed to do business in California under either the Real Estate Law, CFLL, or CRMLA, that company would aggregate the mortgage loan origination activity of its California-licensed mortgage loan originators on a quarterly basis, and report those data through NMLSR in its quarterly call reports. Individual call reports would not need to be submitted by each of the individual mortgage loan originators employed by XYZ. On an annual basis, within 90 days following the end of its fiscal year, XYZ Company would have to submit a separate Report of Financial Condition through the NMLSR, containing information about its company finances.

It is important to note that neither of these SAFE Act-required reports can be customized by individual states. For that reason, if California wishes to obtain information from its mortgage loan originator licensees, which is different from, or in addition to the information which is required of these individuals pursuant to the SAFE Act, California must require the submission of separate reports containing this information. SB 36 contained an individual reporting requirement of this type, to provide DRE with certain information about its mortgage loan originators, which the Department had previously lacked, and which was not required by the SAFE Act. These additional reports, called "business activity reports" by DRE, are intended to provide DRE with information it can use to focus its limited examination resources on licensees most in need of regulatory review. The information requested in these reports is focused on those activities, which pose the greatest potential risk of harm to the public.

SB 36 did not require CFLs or RMLs to submit additional, separate reports, because the CFLL and the CRMLA already require submission of annual reports by these licensees.

Funding Background

Funding for the SAFE Act: Recognizing that the SAFE Act introduced new workload requirements for DRE, the Legislature approved $2.8 million and 27 positions in the 2010-11 budget for the implementation of SB 36. The Legislature also approved 8 positions and $1.285 million to address new workload requirements stemming from the SAFE Act at DOC.

There were no additional increases to either department's budget approved in the 2011-12 budget. However, DRE did submit a request that was considered and denied without prejudice during a budget subcommittee hearing, it is important to note that the state's fiscal situation played a role in determining the need of each department.

Proposed 2012-13 Budget: DOC is funded from special funds and reimbursements, with the largest amount of support provided by the State Corporations Fund. The 2012-13 budget proposes expenditures of $45.3 million and would support 314.7 positions. The lender-fiduciary division of DOC is responsible for the licensing and regular examination of mortgage bankers and lenders which are activities that require oversight pursuant to the SAFE Act. The proposed 2012-13 budget includes 154.3 positions for the lender-fiduciary division of DOC.

Much like DOC, DRE is funded through special funds. The 2012-13 budget proposes expenditures of $47.1 million to support 348.7 positions in the department. Support for the implementation of the SAFE Act is integrated into several divisions within DRE, including licensing and education, enforcement, audits and recovery and administration.

Vacant Positions: As of January 23, 2012 there were 33 vacancies at DOC. The Department was subject to the statewide hiring freeze from August 31, 2010 thru September 28, 2011. The tables below represent historical data reflecting the authorized positions within DOC and DRE and vacant positions within each program.

There are no new proposals for either department included in the 2012-13 budget proposal.

The Department of Corporations

Authorized Positions	2007-08	2008-09	2009-10	2010-11	2011-12
Program 10: Investment	160.5	166.8	167.8	167.9	161.0
Program 20: Lender-Fiduciary	151.9	153.2	154.2	164.1	159.0
Program 50.01: Administration	58.0	58.0	60.0	66.0	66.0
Program 50.02: Distributed Admin.	-58.0	-58.0	-60.0	-66.0	-66.0
Total Authorized Positions	312.4	320.0	322.0	332.0	320.0
Vacant Positions					
Program 10: Investment	16.0	12.0	15.0	19.0	21.0
Program 20: Lender-Fiduciary	32.0	11.0	10.0	23.0	22.0
Program 50.01: Administration	6.0	5.0	7.0	14.0	12.0
Program 50.02: Distributed Admin.	-6.0	-5.0	-7.0	-14.0	-12.0
Total Vacant Positions	48.0	23.0	25.0	42.0	43.0

The Department of Real Estate

*includes 12 vacancies that are subject to workforce cap plan reduction proposed in 2012-13 budget

Authorized Positions	2007-08	2008-09	2009-10	2010-11	2011-12
Program 10: Licensing and Education	59.5	58.5	57.5	72.5	72.5
Program 20: Enforcement, Audits and Recovery	176.5	177.5	179.5	202.5	202.5
Program 30: Subdivisions	57	56	51	38	38
Program 40.10: Administration	49	52	53	55	55
TOTAL AUTHORIZED POSITIONS	342	344	341	368	368
Vacant Positions					
Program 10: Licensing and Education	2	6.5	5	2	1
Program 20: Enforcement, Audits and Recovery	5	15	12	3	12.5
Program 30: Subdivisions	2	8	5	0	1
Program 40.10: Administration	8	7	1	6	2
TOTAL VACANT POSITIONS	17	36.5	23	11	16.5*

Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

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

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

Consultant: Brian Annis

State and Local Finance / Business Development

Item Number and Title **Page**

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

Issues Suggested for Vote Only:

State Treasurer's Office and Related Financing Boards

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

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

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

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

Staff Recommendations: Approve the Treasurer's budget requests.

Vote:

Issues Suggested for Discussion / Vote:

0520 Secretary for Business, Transportation and Housing

Department Overview: The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 12 departments, including the following large departments:

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

In addition, the Secretary's Office oversees programs, including the following, which are budgeted directly in the Secretary's Office:

- Infrastructure and Economic Development Bank
- Film Commission
- Small Business Loan Guarantee Program
- Tourism Commission

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

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

(See budget issue on next page)

Issue 1 – Major Reorganization of the Agency

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

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

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

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

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

BT&H Agency Proposed Reorganization

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

* Functionally within BT&H, but statutorily independent.

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

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

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

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

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

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

Vote:

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

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

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

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

(See budget issue on next page)

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

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

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

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

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

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

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

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

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

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

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

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

Vote:

9210 Local Government Financing

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

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

(See budget issue on next page)

Issue 1 – Reimbursements to Amador and Mono Counties

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

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

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

2012-13 appears to be a Test 1 year.

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

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

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

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

8880 Financial Information System for California (FI$Cal)

Department Overview: The Financial Information System for California (FI$Cal), is an Enterprise Resource Planning (ERP) information technology (IT) project intended to replace, consolidate, and upgrade multiple legacy financial systems with a single system that would encompass the areas of: budgeting; accounting; procurement; cash management; and financial management. The development of FI$Cal resides with four "Partner Agencies," the Department of Finance, the State Treasurer's Office, the State Controller's Office, and the Department of General Services. The FI$Cal system has been in development for several years, but is now at a critical juncture because the Administration selected a contractor or "systems integrator" on March 1, 2012, to implement the system. To move forward with the contract and expenditures, legislative approval is required. Included in this budget item is funding for the contract staff and State staff that manage the project, and funding for the selected systems integrator, which is Accenture. Accenture would implement this ERP IT system using Oracle's PeopleSoft software.

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

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

(See budget issue on next page)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Debt Service General Obligation Bonds and Commercial Paper (9600)

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

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

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

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

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

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

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

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

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

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

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

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

General Obligation Cash Proceeds (Dollars in millions)

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

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

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

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

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

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

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

9620 Cash Management and Budgetary Loans

Department Overview: This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes [RANs]). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is scored as a budget solution, whereas cashflow borrowing is not counted as a budget solution (only a cash solution).

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

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

(see discussion issue on next page)

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

Governor's Proposal: As indicated in the introduction to this section, the Governor requests $39 million General Fund to pay interest on outstanding special-fund loans – this is budgeted in item 9620. Interest is only repaid when the loan principal is repaid. The amount of principal repaid is $486 million. The amount of total special fund loans outstanding as of December 31, 2010, is $3.1 billion, according to the Department of Finance.

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

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

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

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

Staff Comment: Generally, decisions about special fund loans will be made in the budget Subcommittees by subject-matter area, although the 9620 Budget Item should be made to conform. A high-level staff review of the proposed loan repayments and fund condition statement suggests some of loans proposed for repayment could be deferred for additional budget savings in 2012-13 if necessary. The Budget Committee may want to hold final determination on loan repayments until the May Revision when final revenue forecasts are known.

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

Governor's Budget Plan for Loan Repayment in 2011-12 and 2012-13
($ in thousands)

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

SUBCOMMITTEE NO. 4 Agenda

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

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

Consultant: Brian Annis

Hearing Outcomes

State and Local Finance / Business Development

Item Number and Title **Page**

Proposed Vote-Only Issues:

Proposed Discussion / Vote Issues:

Issues Suggested for Vote Only:

State Treasurer's Office and Related Financing Boards

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

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

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

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

Staff Recommendations: Approve the Treasurer's budget requests.

Action: Approved budget requests on a 3 – 0 vote.

Issues Suggested for Discussion / Vote:

0520 Secretary for Business, Transportation and Housing

Department Overview: The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 12 departments, including the following large departments:

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

In addition, the Secretary's Office oversees programs, including the following, which are budgeted directly in the Secretary's Office:

- Infrastructure and Economic Development Bank
- Film Commission
- Small Business Loan Guarantee Program
- Tourism Commission

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

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

(See budget issue on next page)

Issue 1 – Major Reorganization of the Agency

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

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

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

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

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

BT&H Agency Proposed Reorganization

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

* Functionally within BT&H, but statutorily independent.

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

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

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

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

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

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

Action: Approved the BT&H Agency budget on a 3 – 0 vote.

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

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

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

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

(See budget issue on next page)

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

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

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

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

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

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

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

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

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

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

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

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

Action: Held open the GO Biz budget at the request of the Administration so the funding level can be reexamined.

9210 Local Government Financing

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

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

(See budget issue on next page)

Issue 1 – Reimbursements to Amador and Mono Counties

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

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

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

2012-13 appears to be a Test 1 year.

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

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

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

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

Action: Issue held open.

8880 Financial Information System for California (FI$Cal)

Department Overview: The Financial Information System for California (FI$Cal), is an Enterprise Resource Planning (ERP) information technology (IT) project intended to replace, consolidate, and upgrade multiple legacy financial systems with a single system that would encompass the areas of: budgeting; accounting; procurement; cash management; and financial management. The development of FI$Cal resides with four "Partner Agencies," the Department of Finance, the State Treasurer's Office, the State Controller's Office, and the Department of General Services. The FI$Cal system has been in development for several years, but is now at a critical juncture because the Administration selected a contractor or "systems integrator" on March 1, 2012, to implement the system. To move forward with the contract and expenditures, legislative approval is required. Included in this budget item is funding for the contract staff and State staff that manage the project, and funding for the selected systems integrator, which is Accenture. Accenture would implement this ERP IT system using Oracle's PeopleSoft software.

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

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

(See budget issue on next page)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Action: Issue held open.

Debt Service General Obligation Bonds and Commercial Paper (9600)

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

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

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

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

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

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

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

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

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

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

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

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

General Obligation Cash Proceeds
(Dollars in millions)

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

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

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

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

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

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

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

Action: Informational issue – no action taken.

9620 Cash Management and Budgetary Loans

Department Overview: This budget item appropriates funds to pay interest costs on General Fund borrowing used to overcome cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes [RANs]). This item additionally pays interest costs for budgetary borrowing by the General Fund from special funds. Budgetary borrowing is across fiscal years and is scored as a budget solution, whereas cashflow borrowing is not counted as a budget solution (only a cash solution).

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

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

(see discussion issue on next page)

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

Governor's Proposal: As indicated in the introduction to this section, the Governor requests $39 million General Fund to pay interest on outstanding special-fund loans – this is budgeted in item 9620. Interest is only repaid when the loan principal is repaid. The amount of principal repaid is $486 million. The amount of total special fund loans outstanding as of June 30, 2012, is $3.1 billion (under the Governor's plan).

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

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

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

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

Staff Comment: Generally, decisions about special fund loans will be made in the budget Subcommittees by subject-matter area, although the 9620 Budget Item should be made to conform. A high-level staff review of the proposed loan repayments and fund condition statement suggests some of loans proposed for repayment could be deferred for additional budget savings in 2012-13 if necessary. The Budget Committee may want to hold final determination on loan repayments until the May Revision when final revenue forecasts are known.

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

Action: Took no action (if special fund loan repayments are adjusted by this or another subcommittee, this item could be adjusted at a later time to conform interest payments to those actions).

Governor's Budget Plan for Loan Repayment in 2011-12 and 2012-13
($ in thousands)

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

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

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

Thursday, March 15, 2012
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Item Number and Title

8940	California Military Department
8955	California Department of Veterans Affairs
0690	California Emergency Management Agency

(See Table of Contents on page 2 for a More Specific Listing of Issues)

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-324-9335. Requests should be made one week in advance whenever possible.

AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 3)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2012-13 Amount	Fund Source	Staff Recommendation
	California Military Department (8940)			
1	144th California Air National Guard Firefighters	$0 (position authority only)	Federal Funds	APPROVE
2	Departmental Reduction in Reimbursement Authority	$25,000	Special Funds	APPROVE
	Department of Veterans Affairs (8955)			
3	Yountville Veterans Home cemetery renovation	$2.41 million	Federal Funds	APPROVE
4	Sharing Agreements to Civil Service Positions	$0 (position authority only)	General Fund	APPROVE
	California Emergency Management Agency (0690)			
5	Federal Justice Grant Stimulus	$300,000	Federal Funds	APPROVE
6	Re-appropriation of Bonds	$5.7 million	Prop 1B	APPROVE

Vote:

Issues Proposed for Vote Only – Issue Descriptions

California Military Department

For overview and budget information regarding this department, please see page 6 of this agenda.

Issue 1 – 144th California Air National Guard Firefighters

Governor's Budget Request: The Governor's 2012-13 budget requests the authority for three new positions in order to hire firefighters at the 144th fighter wing in Fresno. The National Guard Bureau will absorb the cost of all three positions.

Background: The 144th California Air National Guard Fire Protection responds to a variety of emergencies to include: response to in flight emergencies to Department of Defense assets, civilian aircraft, structural fire response and medical response. The California Air National Guard Fire Department is 100 percent federally funded.

Issue 2 – Decrease Departmental Reimbursement Authority

Governor's Budget Request: The Governor's 2012-13 budget requests that the California Military Department reduce its reimbursement authority by $11.217 million. The reduction in reimbursement authority stems from grants that are no longer being funded and a reduction in reimbursements to the Military Support to Civil Authority and Youth Programs.

Background: The reduction in reimbursement authority stems from grants that are no longer being funded and a reduction in reimbursements to the Military Support to Civil Authority and Youth Programs. This proposal would allow the California Military Department to realign their budget to more accurately reflect spending authority with actual expenditures.

California Department of Veterans Affairs

For overview and budget information regarding this department, please see page 11 of this agenda.

Issue 3 – Yountville Veterans Home: Veterans Cemetery Renovation Reappropration

Governor's Budget Request: The Governor's 2012-13 budget requests a re-appropriation of $2.411 million of Federal Trust Fund Authority approved in the 2011 budget act for the construction phase of the Veterans Home of California – Yountville cemetery renovation project.

Background: The Veterans Memorial Grove Cemetery located on the grounds of the Veterans Home California – Yountville covers approximately 10.2 acres. The cemetery is reserved for veterans that reside at any of the veterans homes throughout the state. Over the past couple of decades the condition of the cemetery has deteriorated and is in need of repair in order to meet National Cemetery Administration standards.

$436,000 of General Obligation bonds were approved for both the preliminary plans and working drawing phases of the renovation project. $223,000 of the initial amount was transferred to the Architectural Revolving Fund on December 27, 2010 to initiate preliminary plans. The remainder was transferred during the 2011-12 Budget Year in order to support the working drawing phase of the project. The development of preliminary plans took longer than anticipated which necessitates the request for the Federal Trust Fund Authority to be approved in the 2012-13 budget act.

Issue 4 – Sharing Agreements to Civil Service Positions

Governor's Budget Request. The Governor's 2012-13 budget requests greater position authority for the California Department of Veterans Affairs. The California Department of Veterans Affairs (CDVA), Veteran Homes of California, Greater Los Angeles and Ventura County (GLAVC) is requesting position authority to convert the funding and positions of shared agreements for positions supporting the Greater Los Angeles and Ventura County homes from the U.S. Department of Veterans Affairs. CDVA is requesting position authority for a total of 22.0 PY by fiscal year 2015 with zero impact to the General Fund.

Background. The Veteran Homes of California (VHC), Greater Los Angeles and Ventura County (GLAVC), is comprised of veteran homes in West Los Angeles, Lancaster, and Ventura. The VHC GLAVC and the U.S. Department of Veterans Affairs entered into a sharing agreement that included pharmaceutical, medical services, and medical supply support. In November 2010 the U.S. Department of Veterans Affairs began cancelling the sharing agreements, citing the lack of a cohesive budget timeline as the reason for the cancellation. The funds that had been encumbered for the sharing agreements will be utilized for the civil service positions and will not impact the General Fund.

California Emergency Management Agency

For overview and budget information regarding this department, please see page 14 of this agenda.

Issue 1 – Federal Justice Grant Stimulus

Governor's Budget Request: The California Emergency Management Agency is requesting that $300,000 in Federal Trust Fund Authority for state operations in order to administer $135 million in Federal Justice Assistance Grant (JAG) Stimulus funding awarded to California.

Background: California received $135.7 million in JAG Stimulus funding, which was directed to Cal EMA, as part of the Federal Stimulus package for law enforcement assistance. These funds have a four year performance period which extends into 2013. For the final year of the Federal JAG Stimulus funding, FY 2012-13, Cal EMA is requesting $300,000 in Federal Trust Fund Authority to continue to cover the state operations related to the management of the Federal

JAG stimulus funds in order to support the 3.0 temporary positions to administer the $135 million in Federal JAG Stimulus funding and to properly close out the Federal JAG stimulus grant award in 2013. The 3.0 temporary positions will be funded by interest earned on original stimulus funding from the federal government.

Issue 2 – Reappropriation of Bonds

Governor's Budget Request: The California Emergency Management Agency has requested an extension for the liquidation period for the Transit, System Safety, Security and Disaster Response Account, Highway Safety, Traffic Reduction, Air Quality, and Port Security Fund of 2006. The Budget Bill Language associated with this request would extend the period to liquidate encumbrances to June 30, 2013.

Background: The California Emergency Management Agency is requesting a reappropriation of $5.7 million dollars. Without this extension of the period of liquidation, the projects could not be reimbursed after June 30, 2012, and there will be no bond proceeds available until after that date. Currently, agencies awaiting funding for projects that will be affected are located throughout the state. The remaining projects are related but not limited to: Operations & Security Center, Incident Planning, Enhancing Passenger Safety and Security Systems, Bus Stop Improvements, Video Surveillance, Corporation Yard Access Enhancements, Multi-Frequency Emergency Radios, Mobile Emergency Electrical Generators, Security Lighting and Fencing, On-Board Bus Surveillance Systems, CalTrain Right-of-way Fencing, Cameras on Trains & Closed-Circuit Security Cameras.

8950 CALIFORNIA MILITARY DEPARTMENT

Department Overview: The California Military Department is responsible for the command, leadership, and management of the California Army and Air National Guard and five other related programs. The purpose of the California National Guard is to provide military service supporting this state and the nation. The three missions of the California National Guard are to provide: 1) mission ready forces to the federal government as directed by the President; 2) emergency public safety to civilian authorities as directed by the Governor; and, 3) support to the community as approved by proper authority. The California Military Department is organized in accordance with federal Departments of the Army and the Air Force staffing procedures.

Budget Overview: The Governor's Budget proposes $130.8 million ($43.6 million General Fund) and 797.7 personnel years. This reflects a decrease of $9.6 million and 12.5 positions as compared to the 2011-12 budget.

Fund Source	2010-11	2011-12	2012-13 (proposed)
General Fund	$43,938	$42,991	$43,618
Federal Trust Fund	$69,133	$76,758	$77,788
Reimbursements	$8,550	$19,613	$8,396
Mental Health Services Fund	$366	$540	$549
Other Funds	$103	$421	$422
Total Expenditures	$122,090	$140,323	$130,773
Personnel Years	743.4	785.2	797.7

The Military Department also receives Other Federal Funds. These funds are not allocated by the state or deposited in the State Treasury and are not included in program or statewide totals. All of the Other Federal Funds are received from the Federal Government for the support of the federal component of the California National Guard.

Federal Funds – California Military Department

	2010-11	2011-12	2012-13
Expenditures	$911,643	$770,484	$786,665
Personnel Years	4,109.9	4,109.9	4,109.9

Issues Proposed for Discussion / Vote

Issue 1 – STARBASE Program Expansion

Governor's Budget Request: The Governor requests 10.0 new positions to support the establishment of three new Science and Technology Academies Reinforcing Basic Aviation and Science Exploration (STARBASE) program facilities. Funding is being provided by the Department of Defense to begin program operations in 2012-13 and the program will continue to be funded with federal dollars.

Background: The Governor's 2012-13 Budget request includes 10.0 new positions for the establishment of three new STARBASE academies located at Joint Forces Training Base in Los Alamitos, the Fresno Air National Guard Base and the Defense Language Institute in Monterey. There is no federal requirement for state matching funds and the program will continue to be fully federally funded.

California's existing STARBASE program is located in Sacramento, California and serves more than 3,000 students annually from the nine surrounding school districts. The program targets minority and/or low socio-economic students and utilizes instruction platforms that conform with federal Department of Defense standards. STARBASE participants are provided with hands-on learning opportunities and mathematics plays an integral role in the program.

If the state were to choose to deny the BCP, the California Military Department will forfeit the $1.0 million in federal funding that has been set aside to add three new STARBASE programs in California.

Hearing Questions: The Subcommittee may want to hear from the California Military Department on the following questions:

1. *Has the Military Department determined if these positions could be filled by State Civil Service employees? Are there any benefits to these positions being filled by members of the State Active Duty?*

2. *Are there any benefits to either the student or the military department to these positions being filled by members of the State Active Duty? .*

Staff Comment. According to the Military Department, instructors in the STARBASE program will be members of the State Activity Duty. Due to cost considerations, it may be more economical for the California Military Department to fill these 10.0 positions with a member of the State Civil Service. Staff would like to see analysis that determines if there are any additional cost burdens assumed by the state if these positions are filled by State Active Duty personnel rather than State Civil Service.

Staff Recommendation: Staff recommends this issue be left open until the California Military Department provide the Budget Committee with a cost benefit analysis of utilizing State Civil Service personnel vs. State Active Duty.

Vote:

Issue 2 – State Active Duty Compensation

Governor's Budget Request. The Governor's 2012-13 budget requests a $1.147 million ($495,000 GF) augmentation to support state active duty personnel cost increases that stem from increases approved by Congress.

Background. Currently there are 568.5 State Active Duty positions within the California Military Department. Members of the State Active Duty support a variety of Military Department activities including: support for youth and community outreach programs, administrative support for The Adjutant General, and facility support operations throughout the state. In accordance with Sections 320 and 321 of the Military and Veterans Code, pay for State Active Duty employees is based upon federal military pay scales that are determined by Congress. Compensation is based on each military member's pay grade, duty location, and years of military service.

Hearing Questions: The Subcommittee may want to hear from the California Military Department on the following questions:

1. *What is the Department's current vacancy rate?*
2. *Could you please describe in more detail the process of converting each position? On average, how long does the conversion process take?*
3. *Has the Military Department been prohibited from converting any positions due to its lacking a State Civil Service classification? If so, could you provide us with more detail on those positions?*

Staff Comment. MG Baldwin, the current Adjutant General, has directed his staff to review each State Active Duty position and determine if it is possible to convert the position to a less costly State Civil Service position as it becomes vacant. This review process has led to the conversion of 11 positions to State Civil Service. State Civil Service positions are not subject to housing allowances like State Active Duty positions and have proven to be more cost effective to the state.

Positions Slotted to Convert to SCS

SAD Position	Base Pay+BAH=Salary	SCS Classification	Salary Range
Position Control NCO (E7)	$6687	AGPA	$4400 - $5348
Chief HRO (W4), SP,	$9268	SSM II	$6173 - $6727
Fiscal NCO (E7), Sunburst	$7203	Associate Budget Analyst	$4400 - $5350
Security Forces Admin NCO	$5317	Executive Secretary	$3020 - $3672
Youth Programs Admin NCO	$5317	Executive Secretary	$3020 - $3672
Real Property Tech	$5317	Associate Budget Analyst	$4400 - $5348
Federal Government Liaison	$8493	CEA I	$6173 - $7838

The table provides data that shows progress towards converting positions to State Civil Service is being made. Undoubtedly, this will be a lengthy process where cost savings each year may seem minimal, but over time the savings achieved through conversion will have provide tangible savings to the state's overall budget.

Staff Recommendation: Approve as budgeted

Vote:

8955 CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS

Department Overview: The California Department of Veterans Affairs (CDVA) promotes and delivers benefits to California veterans and their families. More specifically, the CDVA provides: (1) California veterans and their families with aid and assistance in presenting their claims for veterans' benefits under the laws of the United States; (2) California veterans with beneficial opportunities through direct low-cost loans to acquire farms and homes; and (3) the state aged and disabled veterans with rehabilitative, residential, and medical care and services in a home-like environment at the California Veterans Homes. The CDVA operates veterans' homes in Yountville, Barstow, Chula Vista, Ventura, Lancaster and West Los Angeles.

Budget Overview: The Governor's budget proposes $362.3 million ($250.3 million GF) and 2,250.4 positions for the department. If implemented as proposed, General Fund support for the CDVA would increase from $217.1 million in 2011-12 to an anticipated $250.3 million in the budget year.

Summary of Expenditures (in thousands)

Program	2011-12	2012-13
Farm and Home Loans to Veterans	$124,402	$103,938
Veterans Claims and Rights	$9,826	$11,978
Care of Sick and Disabled Veterans	$212,599	$245,959
Other funds	$473	$428
Total	**$347,300**	**$362,303**

Issues Proposed for Discussion / Vote:

Issue 1 – Veterans Homes of California (VHCs)

Governor's Budget Request: The Governor's budget proposes an increase of $33.6 million in 2012-13 for all of the VHCs, including an augmentation of $32.2 million for full-year and one-time adjustments to phase-in staffing and residents in the existing and new VHCs in Greater Los Angeles Ventura County (GLAVC) and provide VHC Redding and VHC Fresno with staff to properly maintain the facility until each facility can be adequately staffed to admit residents.

The January Governor's Budget proposes to continue to ramp-up admissions at the VHCs in West Los Angeles, Lancaster, and Ventura. The Governor also proposes to provide continued resources and staffing related to the construction and activation of two new VHCs in Redding and Fresno. Construction at the Redding facility is scheduled to be completed by March 30 and construction at the Fresno facility is scheduled to be finished by April 20.

Background: The CDVA provides residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 62 or disabled. The VHCs are long-term residential care facilities that provide California's qualified aged or disabled veterans with rehabilitative, residential, medical, and support services in a home-like environment. Once an eligible veteran selects a VHC as his or her long-term care option, and is approved for admission, the veteran becomes a fee paying resident of the VHC. Home residents are veterans of military service ranging from World War II, Korea, Vietnam, Gulf War I, Operation Enduring Freedom, and Operation Iraqi Freedom. Spouses of veterans may also be eligible for VHC membership. The VHCs provide a long-term continuum of care, from domiciliary care at one end of the spectrum, which is similar to independent living accommodations, to skilled nursing care at the other end of the spectrum, which provides continuous skilled nursing or rehabilitation services.

Veterans Homes of California

	Yountville	**Barstow**	**Chula Vista**	**West Los Angeles**	**Lancaster**	**Ventura**
Licensed Beds*	1,203	344	400	84	60	60
Domiciliary Care	Yes	Yes	Yes	No	No	No
Residential Care Facility for the Elderly	Yes	No**	Yes	Yes	Yes	Yes
Intermediate Care Facility	Yes	Yes	No	No	No	No
Skilled Nursing Care	Yes	Yes	Yes	Yes	No	No
Memory Care	Yes	Yes	Yes	Yes	No	No

**Includes suspended beds.*
***Barstow is not currently licensed or budgeted for the Residential Care Facility for the Elderly level of care.*

Construction at the VHC-Redding and VHC-Fresno facilities is scheduled for completion in early spring of 2012. The Governor's 2012-13 budget reflected minimal staff at each facility for basic upkeep and maintenance and did not include staff that would support admissions at VHC Redding or VHC Fresno. When opened, both of these homes will provide the following levels of care: Residential Care Facility for the Elderly and Skilled Nursing Care, including Memory Care services within each level of care.

Hearing Questions: The subcommittee may wish to ask the Administration the following questions.

1. *Does the continued delay of opening both the Redding and Fresno facilities put the state at risk of losing any federal funding?*

2. *Will each of the positions requested in the 2012-13 budget for Redding and Fresno be located on site? Does the number requested reflect staff located at CDVA HQ in Sacramento?*

Staff Comment. Staff agrees with the need to provide adequate staffing to ensure that the facilities are compliant while ramp up at each of the facilities occurs.

Staff Recommendation: Approve CDVA's budget for Veterans Homes (Program 30).

Vote:

Issue 2 – Veterans Claims and Rights

Governor's Budget Request: The Governor's 2012-13 budget requests that $11.9 million dollars and 40.9 Personnel Years be directed towards the department's Veterans Services Division. The Veterans Services Division provides service and assistance to California's veterans, dependents, and survivors. This request reflects an approximately $2.1 million dollar increase over the Administration's 2011-12 budget request.

Background: According to the statistics provided by the USDVA, 15.06 percent of the state's veterans are receiving disability or compensation benefits from the federal government, which lies slightly below the national average of 15.72 percent. Increasing the rate of participation rates for benefits has long been a goal of the Veterans Services division of CDVA. While the state does provide some funding for County Veteran Service Officers (CVSOs) to conduct outreach ($2.6 million dollars annually for all 54 counties) CDVA has limited influence on the outreach operations designed to connect the state's veteran population with federal benefits that they might be eligible to receive. Local agencies, such as CVSOs, or veteran specific non-profits have provided these services to veterans. A hurdle that the Veterans Services division often faces is that a CVSO's presence might vary by county, and are largely controlled by their respective county's board of supervisors. Therefore, the goals established by the CVSOs might not align perfectly with the goals of the Veterans Services division.

There are additional efforts underway to improve the number of veterans in California who receive benefits: Based on direction implemented in the 2010 Budget Act, a Memorandum of Understanding between CDVA and the Department of Motor Vehicles (DMV) was signed that allows veterans to identify themselves when they apply for a driver's license. This information would then be passed on to CDVA, which will lead outreach efforts and ensure that veterans are aware of their available benefits.

Staff Comment: Staff encourages the continued outreach efforts of CDVA. Staff encourages CDVA to continue to collaborate with other state entities to improve statewide outreach to ensure that each veteran in the state is aware of their benefits from the U.S. Department of Veterans Affairs.

Staff Recommendation: Approve CDVA's budget for Veterans Claims.

2400 CALIFORNIA EMERGENCY MANAGEMENT AGENCY

Department Overview: The principal objective of the California Emergency Management Agency (Cal EMA) is to reduce vulnerability to hazards and crimes through emergency management and criminal justice to ensure a safe and resilient California. The Cal EMA coordinates emergency activities to save lives and reduce property loss during disasters and to expedite recovery from the effects of disasters. On a day-to-day basis, the Cal EMA provides leadership, assistance, and support to state and local agencies in planning and preparing for the most effective use of federal, state, local, and private sector resources in emergencies. This emergency planning is based upon a system of mutual aid whereby a jurisdiction relies first on its own resources, and then requests assistance from its neighbors. The Cal EMA's plans and programs are coordinated with those of the federal government, other states, and state and local agencies within California.

During an emergency, the Cal EMA functions as the Governor's immediate staff to coordinate the state's responsibilities under the Emergency Services Act and applicable federal statutes. It also acts as the conduit for federal assistance through natural disaster grants and federal agency support. Additionally, the Cal EMA is responsible for the development and coordination of a comprehensive state strategy related to all hazards that includes prevention, preparedness, and response and recovery.

Budget Overview: The January Governor's Budget provides Cal EMA with 545.2 positions and $1.3 billion ($113.1 million General Fund).This reflects a decrease of $85 million ($2.5 million General Fund) and 26.1 positions compared to the 2011-12 budget.

Issues Proposed for Discussion / Vote:

Issue 1 – California Specialized Training Institute

Governor's Budget Request: The administration's 2012-13 budget proposal includes a plan to close the CSTI training center by January 1, 2013. CSTI would retain responsibility for development of a curriculum, certifying local agencies, and providing some emergency management training on-location, but many responsibilities for training would shift to locally governed training centers operated by Joint Powers Authorities (JPA). The CSTI staff would be reduced by 20 positions over two years, and federal funds would be diverted to the JPAs. In total, the proposal would reduce the CalEMA budget by $2.0 million in 2012-13 and $4.2 million in 2013-14. Of these amounts, $187,000 in 2012-13 and $377,000 in 2013-14 are from the General Fund.

Background: The CSTI coordinates CalEMA's emergency management training programs. More specifically, CSTI provides training to state, local, federal, private sector, and foreign partners. The curriculum at the facility includes the state's standardized emergency management system, hazardous material response, and contingency planning amongst a variety of other disaster mitigation related activities.

Approximately 30 percent of its training is provided by state instructors on-site at the CSTI training center in San Luis Obispo, often utilizing the center's specialty facilities and equipment (including prop tanker railcars, big-rig trucks, a firing range, and a mock courtroom). Most of the courses (about 70 percent) are taught by instructors who travel to trainees' local areas. According to the administration, funding for CSTI comes from a combination of federal grant funds ($2.1 million), reimbursements from local authorities ($3.8 million), and the state General Fund ($1 million) and supports 26 authorized positions. Local authorities are currently responsible for the costs associated with their employees traveling to the San Luis Obispo center to receive training, including overtime, subsistence, and backfilling necessary positions while trainees are away.

Hearing Questions: The subcommittee may wish to ask the following questions of the Administration.

1. *Have you determined if any costs will be absorbed by other local or state entities related to this move?*
2. *Are there any environmental concerns that would need to be addressed prior to relocating/dismantling the facility? If there are, who would be expected to pay for the environmental cleanup?*

Staff Comment. While reducing the cost burden to local governments does make this proposal worthy of consideration, there are concerns that the cost of dismantling the facility in San Luis Obispo will exceed any savings that are expected to come from the relocation of CSTI. There is limited information related to the cost of dismantling the facility.

Staff Recommendation: Staff recommends that this item be left open until additional analysis can be provided.

Vote:

Issue 2 – Reorganization of the California Emergency Management Agency

Governor's Budget Request: The Governor's 2012-13 budget proposal includes a plan to eliminate Cal EMA and absorb the functions of Cal EMA into the Governor's office. The Administration has suggested that they would be utilizing the Governor's Reorganization Plan (GRP).

Background: Existing law authorizes the Governor to examine periodically the organization of all agencies and to determine what changes are necessary for the provision of government services, including the reduction of the number of agencies through consolidation or abolishment of agencies or functions that may not be necessary for the efficient operation of the state government.

Cal EMA's existence in 2009 stems from AB 38 (Nava) which consolidated the functions of the Governor's Office of Emergency Services and the Governor's Office of Homeland Security into a single agency that would be responsible for the response to major disasters in support of local agencies throughout the state. While details are limited, it would appear that all functions and staff at Cal EMA would be absorbed by the Governor's office. The Governor's office would then assume the role of emergency coordination with local agencies and disaster response throughout the state.

The administration is projecting minimal savings from the elimination and absorption of Cal EMA into the Governor's office, but there is potential for the state to respond more effectively to any disaster by consolidating authority for response directly into the Governor's office.

We expect more details to unfold as the GRP process moves forward, and have presented this item as an opportunity to hear from the agency, administration and the LAO on any additional details that they might have.

Hearing Questions: The subcommittee may wish to ask the following questions of the Administration.

1. *Could you elaborate on some of the deficiencies of the current structure?*

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

Staff Comment. We expect more details to unfold as the GRP process moves forward, and have presented this item as an opportunity to hear from the agency, Administration, and the LAO on any additional details that they might have.

Staff Recommendation: This is an informational item.

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

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

Thursday, March 22, 2012
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Item Number and Title

2150	California Department of Financial Institutions
2180	California Department of Corporations
1760	California Department of General Services

(See Table of Contents on page 2 for a More Specific Listing of Issues)

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AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 2)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2012-13 Amount	Fund Source	Staff Recommendation
	Department of General Services (1760)			
1	Board of State and Community Corrections: Budgeting and Accounting Contract Services	$250,000	Service Revolving Fund	APPROVE

Vote:

Issues Proposed for Vote Only – Issue Descriptions

California Department of General Services

Issue 1 – Board of State and Community Corrections: Budgeting and Accounting Contract Services

Governor's Budget Request: The Governor's 2012-13 budget is requesting augmentation to fill three permanent staff positions totaling $250,000 to perform budgeting and accounting functions to a new state agency client, the Board of State and Community Corrections.

Background: As part of the Governor's public safety realignment of 2011, AB 109 was enacted for lower-level offenders to be sentenced, treated, housed and supervised at the local level. Additionally, SB 92, which eliminated the Corrections Standards Authority with California Department of Corrections and Rehabilitation (CDCR) and reorganized the Corrections Standards Authority to an independent Board of State and Community Corrections was passed. With the passage of SB 92, Corrections Standards Authority is to become a separate entity independent from Department of Corrections and Rehabilitation and reconstituted as an independent Board of State and Community Corrections commencing on July 1, 2012.

The Board of State and Community Corrections believes that it would be more efficient to contract its budgeting and accounting functions post reorganization to the Department of General Services (DGS), Contracted Fiscal Services. As a result, the Board of State and Community Corrections has requested DGS' Contracted Fiscal Services serve as the budgeting and accounting entity for the Board of State and Community Corrections. Currently, DGS' Contracted Fiscal Services does not have ample staff to perform the budgeting and accounting functions for the Board of State and Community Corrections in addition to its current responsibilities and has requested that three additional staff be provided on a full cost recovery basis. The Board of State and Community Corrections is requesting funding for various external contractual work including budgeting and accounting services in their 2012-13 Budget Change Proposal.

2150 CALIFORNIA DEPARTMENT OF FINANCIAL INSTITUTIONS

Department Overview: The Department of Financial Institutions (DFI) was established effective July 1, 1997, to regulate depository institutions, including commercial banks, savings associations, credit unions, industrial loan companies, and certain other providers of financial services. In addition, the Department licenses and regulates issues of payment instruments, including companies licensed to sell money orders and/or travelers checks or licensed to engage in the business of transmitting money abroad, and business and industrial development corporations. Programs are supported by assessments of the various industries, license and application fees, and charges for various other services.

Budget Overview: The Governor's Budget provides DFI with 263.1 positions and $35.4 million (no General Fund). This is an increase of $900,000 and no increase in positions. The Department of Financial Institutions is largely funded by assessments on financial institutions.

Expenditures	2010-11	2011-12	2012-13
Banks	$20.8	$22.5	$22.9
Money Transmitters	$2.9	$3.1	$3.3
Credit Unions	$6.5	$7.3	$7.4
Other Programs	$1.2	$1.5	$1.5
Total Expenditures	**$31.6**	**$34.5**	**$35.2**
Personnel Years	**269.2**	**263.1**	**263.1**

The Governor's Budget includes a proposal to combine the Department of Financial Institutions with the Department of Corporations. This new entity would be referred to as the Department of Business Oversight. At this point, other than it would likely be considered as part of the Governor's Reorganization Plan, there are limited details available.

Issues Proposed for Discussion / Vote

Issue 1 – Conversion of Bank Examiner Positions

Governor's Budget Request: The Governor requests the conversion of 5.0 limited term positions to permanent status. The limited term positions are currently funded at the Senior Financial Institutions Examiner level and this Budget Change Proposal will retain that funding and position authority permanently.

Background: The Banking Program within the Department of Financial Institutions is responsible for the supervision and regulation of banks, industrial banks, foreign banks, savings associations, trust companies, business and industrial development corporations and bank holding companies. The mission of the program is to protect the public and ensure the safety and soundness of licensees through an extensive supervision process that includes on-site examinations, off-site monitoring, the enforcement of laws and regulations, and a licensing application screening process.

In 2010, the Legislature approved five limited term positions within the Department's Banking Program that were requested in a Spring Finance Letter. The limited term positions were originally approved under the assumption that financial conditions would improve and the number of troubled financial institutions would decrease over time. According to the Department of Financial Institutions, the number of problem licensees has in fact increased and the workload for examiners has also increased. The increased workload means that examiners are now conducting additional on-site examinations, taking enforcement action when necessary, and providing additional off-site monitoring of licensee's.

According to the Department of Financial Institutions, the Banking Program is allocated 105 examiner positions. However, due to the hiring freeze, the Program is operating with 90 examiners. Their workload projections reflect a need for 110 examiners in order to properly carry out its stated mission.

Hearing Questions: The Subcommittee may want to hear from the Department of Financial Institutions on the following issues:

1. *Did the Department explore the option of waivers or any other method to retain staff other than requesting these positions be converted to permanent staff?*

Staff Comment: According to the Department of Financial Institutions, the Banking Program is allocated 105 examiner positions. However, due to the hiring freeze, the Program is operating with 90 examiners. Their workload projections reflect a need for 110 examiners in order to properly carry out its stated mission. The Department of Financial Institutions indicates that per State Personnel Board regulations the individuals in those positions cannot be extended on another limited-term basis. The personnel currently in the requested positions have been trained by the Department of Financial Institutions and it is in the consumer's best interest that they remain at the department.

Staff Recommendation: Approve as Budgeted and Supplemental Reporting Language (SRL)

Vote:

Issue 2 – Conversion of Credit Union Examiner Positions

Governor's Budget Request: The Governor's 2012-13 Budget requests the conversion of 3.0 limited term positions to permanent status. The limited term positions are currently funded at the Senior Financial Institutions Examiner level and this Budget Change Proposal will retain that funding and position authority permanently. This request will reflect a cost of $326,000 in the budget year and $326,000 in budget year plus one.

Background: The Credit Unions Program within the Department of Financial Institutions is responsible for the continued oversight of its credit union licensees and is required by statute to examine each of its credit union licensees at least once every two years. Three limited term positions were approved as part of a Spring Finance Letter in 2010.

Similar to the bank examiner positions, conditions in the industry have not improved enough to mitigate extra workload conditions for credit union examiners. The department expects this will result in actual workload increases in some areas and has increased workload requirements related to enforcement actions. According to metrics utilized by the Department to determine the overall health of a State chartered credit union, the number of licensees operating in a satisfactory condition in 2010 was slightly over fifty percent. Particularly, full safety and soundness examinations are expected to increase in 2012 and 2013 and follow-up examinations are expected to increase in 2012 and in 2013 as well.

Hearing Questions: The Subcommittee may want to hear from the Department of Financial Institutions on the following issues:

1. *Did the Department explore the option of waivers or any other method to retain staff other than requesting these positions be converted to permanent staff?*

Staff Comment. Normally, staff would recommend that a continuation of limited term status for the requested positions, unfortunately, The Department of Financial Institutions indicates that per State Personnel Board regulations the individuals in those positions cannot be extended on another limited-term basis. The personnel currently in the requested positions have been trained by the Department of Financial Institutions and it is in the consumer's best interest that they remain at the department. In light of the constant fluctuations to the industry, it may be in the Subcommittee's best interest to ask for a review of examiner positions at the Department of Financial Institutions in two years.

Staff Recommendation: Approve as Budgeted and SRL.

Vote:

2180 CALIFORNIA DEPARTMENT OF CORPORATIONS

Department Overview: The Department of Corporations, under the direction of the California Corporations Commissioner, provides consumer and investor protections by regulating the conduct of a variety of businesses, including securities brokers and dealers, investment advisers and financial planners, and certain fiduciaries and lenders. The Department also oversees the offer and sale of securities, franchises, and off-exchange commodities.

The mission of the Department of Corporations is to ensure an orderly and transparent marketplace for investors, borrowers, and industry through licensure and oversight. Promote financial literacy and educate the public about the risks and rewards in investing and borrowing. Foster a professional and innovative working environment. Protect the public from fraud and abuse through enforcing California's financial services laws.

The Governor's 2012-13 Budget proposes a total of $45.3 million and 314.7 Personnel Years for the Department of Corporations. The department is funded from special funds and reimbursements, with the largest amount of support provided by the State Corporations Fund.

As mentioned earlier, the Governor's Budget proposes to combine the Department of Corporations with the Department of Financial Institutions to create new entity currently referred to as the Department of Business Oversight and would fall under the Business and Consumer Services Agency. Both entities currently regulate and provide oversight to business entities within the financial industry so there is merit to the Governor's proposal, but there is still a limited amount of details on this proposal.

Expenditures	2010-11	2011-12	2012-13
Investment Program	$16.1	$24.0	$23.2
Lender-Fiduciary Program	$16.1	$22.8	$22.1
Total Expenditures	**$32.1**	**$46.8**	**$45.3**
Personnel Years	**275.4**	**313.8**	**314.7**

Issues Proposed for Discussion / Vote:

Issue 1 – Information Technology Quality Network Project (DOCQNET)

Governor's Budget Request: The 2012-13 Budget requests the reappropriation of 7.0 limited term positions and $6.1 million over two years in order to complete the Department's replacement of many of its Information Technology platforms.

Background: In January 2007, the California Bureau of State Audits found that the Department failed to meet many of its regulatory requirements and mandatory time frames and demonstrated a lack of timeliness in resolving complaints from the public. The audit went into greater detail describing many of the manual processes required to track regulatory progress, billing information, and complaints. The audit concluded with a recommendation that the Department should "consider assessing the need for new automated data systems or determining whether its current systems are capable of collecting the necessary information".

Many applications were built in-house using tailor-made software or by small consulting firms. The systems were developed in a variety of languages and on different platforms. The existing project is one of several designed to unify, standardize, and combine data. Subsequently, the Department conducted a Feasibility Study Report (FSR) that found there was a lack of integration amongst the various Information Technology platforms at the Department.

The approved FSR indicated a completion date for this project by June 2012. However, hiring freezes, work furloughs, and unexpected leaves of absence have stalled the project and it is unlikely that it will meet the projected completion date. The Department currently projects that the contract will be executed by April 2012 and the project will be complete by June 2014.

Hearing Questions: The Subcommittee may want to hear from the Department of Corporations on the following issues:

1. *Did the Department have a workaround solution for unexpected hardware/software failures?*

2. *Has the Department considered the impact that the proposed merger will have on the implementation of the Information Technology Network Platform? Will there be any compatibility concerns that need to be addressed?*

Staff Comment: Committee staff does not have any issues with extending the timeline for the already approved Information Technology Quality Network Project.

Staff Recommendation: Approve as budgeted.

Vote:

Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

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

Thursday, March 22, 2012
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultant: Brady Van Engelen

Hearing Outcomes

Item Number and Title

2150	California Department of Financial Institutions
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AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	2012-13 Amount	Fund Source	Staff Recommendation
	Department of General Services (1760)			
1	Board of State and Community Corrections: Budgeting and Accounting Contract Services	$250,000	Service Revolving Fund	APPROVE

Vote Only item approved 3-0

Issues Proposed for Discussion / Vote

Issue 1 – Conversion of Bank Examiner Positions

Item approved 3-0

Issue 2 – Conversion of Credit Union Examiner Positions

Item approved 3-0

2180 CALIFORNIA DEPARTMENT OF CORPORATIONS

Issue 1 – Information Technology Quality Network Project (DOCQNET)

Item approved 3-0