AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON GENERAL GOVERNMENT

PART 1

ASSEMBLYMEMBER JOHN DUTRA, CHAIR

WEDNESDAY, MAY 19, 2004
STATE CAPITOL, ROOM 437
12:00 P.M.

ITEMS ON CONSENT

ITEMS TO BE HEARD

ITEMS ON CONSENT

ITEM 0860 STATE BOARD OF EQUALIZATION

ISSUE 1: APRIL 1 FINANCE LETTER

The Department of Finance requested the following adjustments to the BOE's budget:

1. Twice-Monthly Reporting for Cigarette and Tobacco Products Distributors – augmentation of \$53,000 (\$27,000 GF). This augmentation funds 0.5 PY and contract costs to implement the provisions of Chapter 867, Statutes of 2003 (AB 1666, Cogdill).

2. DMV Fee Increase - augmentation of \$687,000 (\$550,000 GF). This augmentation reflects increased costs of the Department of Motor Vehicles (DMV) to collect use tax on vehicle sales on behalf of BOE.

At its April 27 hearing, the subcommittee held these issues open pending a reallocation of costs to reduce the General Fund cost share to the General Fund share of revenue produced by these programs. The appropriate action now is to reduce the General Fund amounts by \$21,000 and \$103,000 respectively (total of \$124,000) with an equivalent increase in other funds.

ISSUE 2: RECOGNITION OF FIELD OFFICE SAVINGS

The board is closing its Torrance field office in September and consolidating the staff in the Culver City field office. The Department of Finance indicates that this will result in savings of \$370,000 (\$240,000 GF) that have not yet been recognized in the board's 2004-05 budget.

Staff Recommendation: Recognize the savings (reduce by total of \$370,000). CONSENT.

ITEM 9620 PAYMENT OF INTEREST ON GENERAL FUND LOANS

This item provides for GF interest costs for short-term, cash-flow borrowing. The Budget Bill appropriates $30 million for interest payments on *internal* borrowing from special funds within the State Treasury. Costs for *external* borrowing on the open market (by issuing Revenue Anticipation Notes, RANs, or Revenue Anticipation Warrants, RAWs) are continuously appropriated. The budget anticipates issuance of a $4 billion RAN in 2004-05 and includes $137.5 million for interest and other costs associated with that borrowing. In addition, the 2004-05 Governor's Budget includes a GF appropriation of $2.361 million for interest payments for budgetary special fund loans.

The item also includes language allowing the Director of Finance to augment the amounts for internal borrowing or for the cost of issuing RAWs (although none are currently proposed) including any credit enhancements, subject to legislative notification.

COMMENT

The subcommittee initially heard this item on March 30 and deferred action pending any update in the May Revision. However, the May Revision does not propose any change. The Department of Finance indicates that it is still evaluating the state's cash-flow situation for 2004-05. Should any change in cash-flow borrowing plans or interest costs be warranted, they can be considered by the Budget Conference Committee.

Staff Recommendation: Approve as budgeted. CONSENT.

ITEM 9650 HEALTH AND DENTAL BENEFITS FOR ANNUITANTS

The state contributes toward health and dental insurance premiums for annuitants of the Judges', Legislators', District Agricultural Employees', and Public Employees' Retirement Systems, as well as specified annuitants of the State Teachers' Retirement System. Annuitants have the option of selecting from up to eight state-approved health plans depending on where an annuitant lives. The state's contribution for individuals is the average premium for the four most popular plans. For couples and families, the state also contributes 90 percent of the additional cost over the single premium contribution (based on the average of the four plans).
The Governor's Budget included $856 million from the GF for health and dental benefits for annuitants in 2004-05. This budgeted amount reflects 2004 health insurance premium increases of 18 percent for basic managed care plans and almost 27 percent for Medicare managed care plans, on average. It also assumes similar changes in health insurance premiums that would go into effect January 1, 2005. Although these costs are initially paid from the GF, the state recovers a portion of these costs (about 33 percent) from special funds through pro rata charges.

COMMENT

The subcommittee initially heard this item on April 27 and deferred action pending any update in the May Revision. The May Revision proposes a slight reduction of $1.6 million in dental costs for retirees.

Staff Recommendation: Approve May Revision. CONSENT.

ITEMS TO BE HEARD

ITEM 0860 STATE BOARD OF EQUALIZATION

ISSUE 1: MAY REVISION—RESTORATION OF STAFF FUNDING

Prior Subcommittee Action. At its April 27th hearing the subcommittee discussed an LAO recommendation to shift some BOE positions from non-revenue-producing functions, such as taxpayer services, to restore some of the recent reductions to revenue-producing staff. The board proposed an alternative of restoring funding without shifting any positions. The subcommittee directed the board and LAO to report back to the subcommittee with a proposal that combines some funding restorations *and* some redirection of staff in order to meet the 5-to-1 criterion for revenue gain and minimize adverse impacts on taxpayer services and critical board operations.

May Revision Proposal Is Not Responsive. The May Revision requests $8.3 million ($5.4 million General Fund) in order to restore funding for 160 positions. *No staff redirections are proposed.* The board indicates that this augmentation will eliminate the need to lay off 105 positions and will enable it to fill 55 vacant collector positions. The effect of this action would be to restore most of the personal services funding that was reduced in the current year pursuant to Section 4.10 of the 2003 Budget Act.

The board estimates that this augmentation will result in $38.1 million ($24.8 million GF) of additional revenue in 2004-05 and $48.6 million ($31.6 million GF) in 2005-06 as follows:

- $29.7 million annually ($19.3 million GF) from the retention of 105 positions.
- $8.4 million ($5.5 million GF) in 2004-05 and $18.9 million ($12.3 million GF) in 2005-06 from filling 55 vacant collector positions.

The total revenue gain amounts include sales and use tax gains that benefit local governments.

LAO Recommendation. The LAO estimates that a temporary shift of 20 positions from taxpayer services to audits and collections would result in additional revenues of approximately $6 million in 2004-05. In addition, LAO notes that the BOE has in the past shifted some staff resources from revenue activities to nonrevenue activities such as technology services and call centers and that moving a portion of these positions back revenue areas could generate as much as $20 million in additional revenue. However, LAO also notes that these staffing shifts would likely have some negative impact on taxpayer services. For example, there might be delays in responding to inquiries or even mailing refund checks.

Staff Alternative. The board's May Revision augmentation proposal does examine the alternative of redirecting staff positions to offset at least some portion of the funding restoration. It would seem that at a minimum the LAO's recommendation for a shift of 20 positions could be adopted to reduce the augmentation sought in the May Revision. This would cut the net staff restoration from 160 positions down to 140 positions—still a very substantial restoration—with no loss of revenue production. The cost savings would be 12.5 percent of the request--$1.04 million total ($675,000 GF).

Staff Recommendation: Adopt May Revision as modified by the staff recommendation (restore funding for 140 positions and redirect 20 positions).

ISSUE 2: MAY REVISION—ALTERNATIVE CIGARETTE TAX STAMP

The May Revision requests an augmentation of $4.9 million ($564,000 GF, $1.4 million Proposition 99 funds, $2.8 million Proposition 10 funds, and $113,000 Breast Cancer Research funds) for the alternative cigarette stamps contract. The request includes Budget Bill language requiring Department of Finance approval of a special project report prior to expenditure of the funds. The money will provide contract funds to pay for a new cigarette stamp that would be deployed by January 1, 2005. A new stamp is required by SB 1701, Peace (Chapter 881, Statutes of 2002). For 2005-06, the anticipated full-year cost of the stamp will be $9.8 million.

On a full-year basis, the board expects the new stamp to increase cigarette tax revenues and associated sales tax revenues by $28.2 million ($5.6 million GF). This estimate is based on a 10 percent decline in current estimated losses due to cigarette tax evasion. The board points out that the new stamp also will prevent further erosion of the cigarette tax base due to increased smuggling and counterfeiting.

The current stamp is simply a meter impression that is easy to counterfeit and difficult to verify. The new stamp required by SB 1701 will be one that has modern anti-counterfeiting features (these could include some features found on currencies, such as color-shifting inks, microprint, watermarks or holograms) along with encrypted verification and tracking information that can be scanned by board inspectors.

<u>Comments</u>

- Counterfeiting has become an increasing problem according to the board and industry sources. A growing practice is to counterfeit both the packaging and stamps to make inexpensive foreign-manufactured cigarettes appear to be tax-paid major-brand cigarettes. This practice is a threat to both state revenues and to the revenues of legitimate cigarette manufacturers.
- The projected General Fund gain meets the standard 5-to-1 ratio for revenue gain to cost for revenue enhancement projects (due to the added benefit of sales tax recoveries). However, the gain to the other funds is less.
- Potential stamp suppliers argue that the losses from counterfeiting are larger than the board estimates and that a truly counterfeit-proof stamp would produce greater revenue gains and prevent growth in losses to counterfeiting.
- It is expected that California will be the first state to adopt new counterfeit-proof stamp technology and that other states probably will follow suit after observing California's experience.

Staff Recommendation: Approve the May Revision request with the addition of the following language:

1) **Budget Bill language directing the board to seek financial participation from stamp suppliers through "benefit funding" (a portion of the contract cost would be recovered from revenue gains above an agreed-upon minimum revenue gain).**

2) **Supplemental Report language directing the board to report to the Legislature by November 1, 2005 on the benefits of the new stamp to cigarette manufacturers and potential mechanisms for assessing manufacturers a reasonable and proportionate share of the cost of the stamp.**

ISSUE 3: MAY REVISION— 450 N STREET CURTAINWALL REPAIRS

The May Revision requests $1.2 million ($718,000 GF) for a study, preliminary plans, and working drawings to replace defective neoprene gaskets that hold the glass panels inside the frames of the board's headquarters building in Sacramento. Actual repair costs would be requested in 2005-06. The gaskets have been failing and water has been leaking into the building since the building opened. Studies by the Department of General Services have determined the problem to be a manufacturing defect and the state is exploring legal options against the manufacturer of the gaskets.

Comments

The LAO points out that the board's proposal identifies an option of applying a "wet seal" around the windows, but did not identify a cost for this option. This approach would be temporary since the wet seal would eventually deteriorate and a permanent repair would still need to be made. However, this option might be considerably cheaper than the permanent repair and it might offer much quicker relief from the leakage problem. Given the state's current fiscal shortfalls and the possibility of some legal recovery from the manufacturer, it might make sense to adopt the temporary wet-seal option at this time.

Staff Recommendation: The board should report on the cost of the alternative wet-seal option and the pros and cons of that options compared with the May Revision proposal. If the board is unable to present adequate information at this time, the subcommittee may wish to put this issue in Conference by approving half the requested funding, for example.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

ISSUE 1: REGIONAL HOUSING NEEDS ASSESSMENT MANDATE

Note: This Issue was held over from the previous hearing.

At the Subcommittee's March 30 hearing, the subcommittee heard this issue and took the following initial actions:

1. Augment by $750,000 (General Fund) to fund the portion of the mandate performed by regional Councils of Governments (COGs).

2. Directed staff to develop Trailer Bill Language to present to the subcommittee to improve cost controls and delete unnecessary mandate components for the city and county portion of the mandate.

BACKGROUND

Mandate for Regional Housing Assessments. Chapter 1143, Statutes of 1980 (AB 2853, Roos), significantly expanded the requirements of local housing elements by requiring additional analysis of local housing needs, particularly in relation to housing by income group. Each community is assigned numeric housing development goals by income (that community's "fair share" of housing) through a process administered by the regional COG.

Chapter 1143 was passed after the constitutional amendment requiring mandate reimbursements for state-required activities. Other portions of the housing element process that were in place prior to Chapter 1143 have not been treated as reimbursable mandates. State reimbursement has been provided for the following expenses:

- ***Regional COGs.*** Reimbursable costs include expenses related to the administrative costs of distributing the region's total housing goals to individual communities, including public meetings and any necessary revisions.

- ***Cities and Counties.*** Reimbursable costs include expenses related to reviewing the COGs' allocation and examining a variety of specialized housing factors in their housing element, such as housing availability for the disabled, farmworkers and energy conservation.

STAFF RECOMENDATION

In response to the subcommittee's direction, a working group of staff--including the LAO, DOF, Senate and Assembly budget and housing committee staffs, staff of the Commission on State Mandates, and the department—have held a number of meetings. As a result of these meetings, some new information has come to light.

Existing rules for the housing needs mandate date back to Board of Control decisions that have not been revisited in many years and may now be outdated by further developments in state and federal law, as well as more recent court decisions.

Under existing court rulings, it does not appear that COGs are a type of local entity that is entitled to reimbursement for state mandated costs. Also, COGs appear to have existing fee authority that they can use to cover their costs of preparing housing needs allocations.

Specifically, staff recommends the following actions:

General

- Adopt Trailer Bill Language directing the Commission on State Mandates to revisit the Board of Control decisions for the Regional Housing Needs Assessment Mandate.

COGs

1. Revise the prior action to augment by $750,000 instead to appropriate the funds to the department for a local assistance grant program to provide financial assistance to COGs that are preparing housing local housing goals. and

2. Adopt Trailer Bill Language clarifying that COGs' existing fee authority also includes the authority to recover their costs through fee charges to cities and counties. This would ensure that COGs could meet their local housing needs responsibilities regardless of the availability of state funds.

Cities and Counties

1) Approve the $1,000 mandate deferral item for the city and county portion of the mandate.

2) Adopt Trailer Bill Language as follows:

   a) Authorize the department to adopt regulations establishing standards of effort for complying with the mandate.

   b) Clarify that review or appeal of the COG housing allocation data (as opposed to use of the data) is optional.

   c) Make consideration of energy conservation in the housing plan (but not adherence to energy conservation building standards) optional.