California State Assembly

Assembly Budget Agenda

Subcommittee No. 5 on State Administration

Assemblymember Sharon Quirk-Silva, Chair

Wednesday, May 22, 2024

Upon Call of the Chair – State Capitol, Room 444
(Note time and room change)

INFORMATIONAL HEARING

1. Call to order
2. Member Comments and Questions
3. Public Comment

Major Issues - 2024 Budget

Introduction

Assembly Budget Subcommittee No. 5 on State Administration will conclude its hearings on Wednesday, May 22, 2024, with one final opportunity for Members of the Assembly to provide input, make comments or ask questions regarding any general government issues in the proposed 2024 budget.

Given the State's difficult fiscal position, the 2024 budget process was dominated by discussion of potential solutions to a budget problem. Including the May 22nd hearing, Subcommittee No. 5 held 10 hearings to consider budget issues this year and Subcommittee No. 7 held three additional hearings on issues covered this Subcommittee for a total of 13 hearings.

Major Housing Program Reductions

The Governor's May Revision proposes an additional $500 million in reductions in housing funding. These reductions plus those proposed in January equal about $1.76 billion reductions for housing. The total reductions are outlined in the table below.

Title/Major Initiative	2022-23 PY	2023-24 CY	2024-25 BY	2025-26 BY1	2026-27 BY2	2027-28 BY3	Total
Multifamily Housing Program (MHP)		325.0					325.0
Infill Infrastructure Grant (IIG) Program	10	225.0					235.0
Veteran Housing & Homelessness Prevention Program (VHHP)	26.3	50					76.3
Foreclosure Intervention Housing Preservation Program (FIHPP)	154	82.5	85.0	100.0	62.5		484.0
CalHome		152.5					152.5
Housing Navigators			13.7	13.7	13.7	13.7	54.8
Regional Early Action Planning (REAP) 2.0		300.0					300.0
Adaptive Reuse Program		127.5					127.5
TOTAL							**1,755.1**

Program Detail:

- ***MHP.*** The MHP program received Proposition 1 bond funding for new construction, acquisition and rehabilitation of permanent or transitional rental housing, and the conversion of nonresidential structures to rental housing for low-income households. In addition to bond funding, the MHP program also received discretionary General Fund augmentations of $425 million in 2022-23 and 2023-24. The Governor's 2024-25 budget proposes to reduce General Fund support for MHP by $250 million and the May Revision proposes to further reduce General Fund support by $75 million for a total reduction of $325 million.

Multifamily Housing Program

Awards and Units Assisted.

Multifamily Housing Program[a]
(In Millions)

	Amount Awarded	Units Assisted
2018-19	$259	1,706
2019-20	310	2,289
2020-21	206	1,251
2021-22	226	1,300
Totals	**$1,001**	**6,546**

[a] Awards made and units assisted after 2021-22 are now part of the consolidated application process.

- Over 95 percent of the units assisted are at or below 60 percent of AMI.
- Of the total funds awarded over this period, 46 percent went to projects in Southern California, 37 percent went to projects in Northern California, and 17 percent went to projects in rural areas.

- ***IIG.*** The IIG Program was created in 2007 within HCD to provide funding for infrastructure that supports higher-density affordable and mixed-income housing in locations designated as infill. Under the program, developers and local governments can partner to apply for infrastructure funding, including the development or rehabilitation of parks or open space; water, sewer, or other utility service improvements; streets; roads; sidewalks; and environmental remediation. Originally, bond funding was provided for the program through the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C) and the Veterans and Affordable Housing Bond Act of 2018 (Proposition 1). Since 2019-20, $775 million General Fund has been provided for the IIG Program. The 2024-25 budget proposes a $200 million General Fund reduction for IIG and the May Revision proposes an additional $35 million in General Fund reductions for a total of $235 million in reductions.

Infill Infrastructure Grant Program

Awards and Units Assisted.

- $567 million has been awarded for IIG between 2019-20 and 2022-23.
- IIG does not fund units, but is estimated to have supported the creation of 10,628 units between 2019-20 and 2022-23.

Remaining Funds and Awards. The administration is currently receiving applications for $94 million in IIG funding for small jurisdictions (funding for large jurisdictions is provided through the consolidated application process described more fully earlier in this handout).

- ***VHHP.*** The VHHP program provides long term loans for the acquisition, construction, rehabilitation, and preservation of affordable multifamily housing for veterans and families. Although the program recently received $50 million General Fund in fund in both 2022-23 and 2023-24, the program has historically been funded through Proposition 46 bond funding. The Governor's 2024-25 budget proposes to reduce the program by $50 million General Fund and the May Revision proposes to reduce the program by an additional $26.3 million for a total reduction of $76.3 million.

Veterans Housing and Homelessness Prevention (VHHP) Program

Awards and Units Assisted.

Veteran's Housing and Homelessness Prevention Program
(Dollars in Millions)

	Amount Awarded	Projects Assisted
2018-19	$66	515
2019-20	78	421
2020-21	—	—
2021-22	125	542
Totals	**$269**	**1,478**

- The administration indicates that between 2015 and 2021, this funding assisted with 3,058 VHHP units.
- Over 70 percent of the population served were individuals experiencing homelessness.

- ***FIHPP.*** The 2021-22 budget provided $500 million one-time General Fund to HCD for the newly established Foreclosure Intervention Housing Preservation Program (the 2023-24 budget reduced this funding by $15 million). The program provides loans and grants to preserve affordable housing and promote resident ownership or nonprofit organization ownership of homes at risk of foreclosure. Specifically, the program requires the preservation of units acquired through this funding for use as affordable housing. Funds are available through December 31, 2025. The Governor's 2024-25 budget proposes to further reduce the funding by $247.5 million and the May Revision proposes to reduce the program by an additional $236.5 million for a total of $484 million. However, in March 2024, the fund manager was selected but was not under contract, and this program was furthered delayed because of the May Revision proposal.

According to the advocates, foreclosure rates exceed pre-pandemic levels. In 2023 alone, 31,136 properties in California received a foreclosure notice. Those buildings are home to approximately 100,500 Californians including thousands of renters whose housing is at risk.

- ***CalHome.*** The CalHome program provides grants to local public agencies and nonprofit corporations for first-time homebuyer and housing rehabilitation assistance, homebuyer counseling, and technical assistance activities to enable low and very low income individuals to become or remain homeowners. Historically, the program has been supported through bond funding. The 2022-23 budget provided $350 million General Fund for CalHome over two years. (The Governor's 2024-25 budget proposes to reduce CalHome by $152.5 million - $102.5 million in 2022-23 and $50 million in 2023-24).

  There is currently about $130 million in Proposition 46 (2002), Proposition 1 (2018), and Proposition 1C (2006) funding remaining for CalHome. Beginning in the summer of 2024, the administration will make $90 million available for CalHome. Awards are expected to be announced in late 2024. Once the remaining $130 million has been spent, there is no additional funding authorized for CalHome.

- ***Housing Navigators.*** The Housing Navigation & Maintenance Program (HNMP) (formerly the Housing Navigators Program) is administered by the California Department of Housing & Community Development (HCD) to county child welfare agencies to provide housing navigators to help young adults secure and maintain housing. The HNMP pays for supportive services for 1,300 foster youth who have a federal housing 2 voucher specifically for former foster youth. These vouchers are known as Family Unification Program (FUP) and Foster Youth to Independence (FYI) vouchers. The program leverages 22.6 million annually from the U.S. Department of Housing and Urban Development (HUD) in the form of special population Housing Choice Vouchers for youth exiting foster care. A condition of this federal funding is the provision of supportive services to participating youth; HNMP funds these supportive services. The Governor's budget proposes to reduce the program by $13.7 million ongoing.

  As of October 2023, a total of 1,341 former foster youth in California hold a voucher and the average monthly per unit cost in California is $1,404, according to HUD's Housing Choice Dashboard, as of November 2023.

- ***REAP 2.0.*** REAP 2.0 is administered by HCD in collaboration with the Governor's Office of Planning and Research, the Strategic Growth Council, and the California Air Resources Board. The program was established in 2022-23 with a $600 million General Fund augmentation. REAP 2.0 is a flexible program that provides grants to local entities with the goal of accelerating infill housing development, reducing vehicle miles traveled, increasing housing supply at all affordability levels, and facilitating the implementation and adoption of regional and local housing plans to achieve these goals. The Governor's 2024-25 budget proposes to reduce REAP 2.0 by $300 million. As of the March 11, 2024 hearing, $536 million had been awarded to local governments for projects, but only 5 percent of funds have actually been requested for reimbursement.

  Testimony at the Budget hearing highlighted that the statute created extensive reporting before funds could be released and that many eligible entities had contracted and obligated funds already in anticipated of reimbursement. According to advocates, a recent inventory estimates that the $510 million to be invested by MPOs will generate 5,500 housing units and further progress on the planning and development of 30,000 more.

- ***Adaptive Reuse Program.*** The 2022-23 budget provides HCD with $400 million General Fund over two years ($150 million in 2022-23 and $250 million in 2023-24) for a new adaptive reuse incentive grant program. Adaptive reuse is the process of adapting and rehabilitating unutilized or under-utilized, generally commercial, buildings for housing. The May Revision proposes to reduce the program by $127.5 million.

Other Housing Reductions

The January budget also includes additional housing reductions to the Department of Housing and Community Development and the Civil Rights Department.

Department(s)	**Title/Major Initiative**	**2022-23 PY**	**2023-24 CY**	**2024-25 BY**	**2025-26 BY1**	**2026-27 BY2**	**2027-28 BY3**	**Total**
Housing and Community Development	Surplus Land Act Unit			2.4	2.4	2.4	2.4	9.6
Civil Rights Department	Shift GF Expenditures to Special Fund			10.0				10.0
Civil Rights Department	Enforcement and Conciliation Resources			2.3				2.3
Total								**21.9**

- **Surplus Land Act Unit.** The 2022-23 budget authorized 12 positions to establish the California Surplus Land Unit to facilitate agreements between local agencies and developers on surplus properties, collect and compile data on housing production on local surplus land pursuant to SB 791 (Chapter 366, Statutes of 2021). This proposal would eliminate the resources for SB 791. The Department of Finance has stated that HCD is resourced within the Housing Accountability Unit to provide technical assistance and enforcement for jurisdictions to comply with the Surplus Lands Act.

- **Enforcement and Conciliation Resources.** The Governor's January Budget proposes two budget proposals to address the deficit resulting in a reduction of $2.3 million for the Civil Rights Department as follows:

    - Eliminate $1.4 million in 2024-25 General Fund previously committed for the enhancement of the Civil Rights Department's (CRD's) enforcement, investigation, and conciliation capacities.
    - Eliminate $883,000 General Fund previously committed to the CRD's Community Conflict Resolution and Conciliation efforts in 2024-25

- **Shift GF Expenditures to Special Fund.** One-time Shift of General Fund Expenditures to Special Fund in the amount of $10 million in 2024-25 to shift General Fund expenditures to the Civil Rights Enforcement and Litigation Fund on a one-time basis. Existing statute authorizes the Civil Rights Enforcement and Litigation Fund to be used for the administration of the Civil Rights Department.

Major New Housing Proposals

- **Low Income Housing Tax Credit (LIHTC).** The May Revision restores the State Low-Income Housing Tax Credit and allows the California Tax Credit Allocation Committee to allocate up to $500 million for the 2025 calendar year in state low-income housing tax credits.

- **Behavioral Health Infrastructure Bond Act Resources.** The May Revision requests 17 positions in 2024-25, and ongoing, 11 positions in 2025-26 and ongoing, and 1 permanent position in 2027-28, and ongoing, funded by the 2024 Behavioral Health Infrastructure Bond Fund, to provide resources to the Department of Housing and Community Development to implement and administer Chapter 789, Statutes of 2023 (AB 531), the Behavioral Health Bond Infrastructure Act.

- **Transition of California Interagency Council on Homelessness (Cal-ICH) to HCD.** The May Revision revises the Governor's January proposal by requesting new position authority for 13 additional position in additional to the 4.0 positions from January for a total of 17.0 positions in 2024-25 and ongoing to integrate and administer the California Interagency

Council on Homelessness (Cal ICH) Homeless Housing, Assistance and Prevention (HHAP) and all other Cal ICH grant programs, as outlined in Chapter 40, Statutes of 2023 (Assembly Bill 129). Cal ICH will also transfer 22.0 existing positions that currently support grant operations to HCD to administer these programs. The additional positions will be dedicated to build out the Governor's proposed Housing and Homelessness Accountability and Results Partnership Unit (HHARP), an expansion of the existing Housing Accountability Unit.

Assembly Considerations

Addressing the state's housing affordability crisis remains a top priority for the Legislature. According to HCD's Statewide Housing Plan, "California must plan for more than 2.5 million homes over the next eight-year cycle, and no less than one million of those homes must meet the needs of lower-income households."

To help meet the affordable housing needs, the state has enacted new policies including streamlining policies and accountability reforms to ensure that housing gets built and not just planned. The Legislature has passed numerous bills to streamlining line housing, shorten the entitlement timeline, and incentivize affordable housing in market rate developments in an effort to pull all the policy levers at its disposal to increase housing at all income levels. On the funding side, since 2019-2020, the state has invested over $18.5 billion ($4.2 billion General Fund) and other funds including bond and federal funds to address the state's housing crisis. These combined approaches have worked together to build units in the state, with the funding accounting for one piece of the puzzle and policy reforms helping to spur additional units to reach the statewide housing goal.

California is at a critical juncture for housing investment as the state faces a budget deficit. Funding from the 2018 bonds are now depleted, the Governor's proposes to cut about $1.2 billion and the May Revision includes an additional $500 million in cuts for a total of $1.75 billion in housing cuts.

Through discussions in Subcommittees 5 and 7, the programs that have risen as priorities include the MHP, REAP 2.0 and the Housing Navigator programs for different reasons.

MHP. Now that the Governor's May Revision proposes to restore the $500 million in Low Income Housing Tax Credits (LIHTC), the MHP program is critical to pair with the LIHTC. Staff notes that without additional funding for MHP, the next round of tax credits will likely not reach the very low, extremely low or acutely low income.

REAP 2.0. During the Sub. 5 hearing on housing, testimony showed the decision to pull back funding for REAP 2.0 stopping projects that were pre-obligated under HCD's rigorous reimbursement process and ultimately hurt the state in reaching more of its housing goals. Pulling back funding for this program will mean that these projects will either not happen or have to wait for additional funding to come along through another program. Further, without this funding, federal funding will be left on the table because the REAP dollars were planned to leverage federal dollars.

Housing Navigator Program. Finally, the Housing Navigator program protects critical housing for our foster youth.

Major Homelessness Programs Reductions

The Governor's January Budget proposed to delay the availability for distribution of $260 million in supplemental Homeless Housing Assistance and Prevention (HHAP) funding from 2023-24 to 2025-26. The Governor's May Revision instead proposes to revert the $260 million back to the General Fund. Additionally, the May Revision reverts an additional $14.84 million on top of the $100.6 million in HHAAP administrative set asides for a total of $115.44 million. Finally, the May Revision includes additional savings from set asides from the Encampment Resolution Grant Fund program in the amount of $33.5 million for a total of $408.94 million in General Fund savings from homelessness programs.

Department(s)	Title/Major Initiative	2022-23 PY	2023-24 CY	2024-25 BY	2025-26 BY1	2026-27 BY2	2027-28 BY3	Total
Business, Consumer Services and Housing Agency	Homeless Housing, Assistance and Prevention (HHAP) Grant Program - Round 5 Supplemental Funding				260.00			260.00
Business, Consumer Services and Housing Agency	Surplus HHAP State Operations Funding		115.44					115.44
Business, Consumer Services and Housing Agency	Sweep Surplus Administrative Set-aside Funds for Encampment Resolution Funds Grant Program			33.50				33.50
Total								**408.94**

Major Proposals for Homelessness

- **Support for Cal-ICH.** As part of the May Revision, the California Interagency Council on Homelessness (Cal-ICH) seeks a new General Fund allocation of $14,835,000 in 2024-25; $9,545,000 in 2025-26; and $7,795,000 annually from 2026-27 on to maintain 23 existing staff position and the contracts necessary to carry out Cal-ICH's statutory functions.

Assembly Considerations

The May Revision continues the commitment for HHAP funding for 2023-24 by leaving the $1 billion that was allocated for 2023-24 intact. However, the budget does not include additional funding for a Round 6 of HHAP nor additional funding for Encampment Resolution Grants.

Housing and Homelessness Accountability Results and Partnership (HHARP) unit. The May Revision creates the HHARP unit, which will expand the Housing Accountability Unit to include homelessness issues, building on existing work to more deeply integrate the state's housing and homelessness investments. This is an opportunity to focus on the accountability provisions created and expanded in HHAP Rounds 3-5. The Governor's January budget and May Revision reverts a little more than $100 million in administration dollars that were underutilized by Cal-ICH and uses the new HHARP unit to take the opportunity to focus, provide technical assistance and hold HHAP recipients accountable. The Assembly should consider using the newly created unit to provide transparency in the administration of homelessness funding.

Major Tax Proposals in Governor's Budget and May Revision

The May Revision in combination with the Governor's budget provides over $15 billion in budget solutions for FY 2024-25 through 2027-28. The budget solutions are displayed in the table below.

Department(s)	GB/ MR	Title/Major Initiative	2022-23 PY	2023-24 CY	2024-25 BY	2025-26 BY1	2026-27 BY2	2027-28 BY3	Total
Franchise Tax Board	MR	Net Operating Losses Suspension and Limitation of Credits to $5 million			900.0	5,500.0	5,900.0	3,600.0	15,900.0
Franchise Tax Board	GB	Permanently Limit NOLs to 80 Percent of Taxable Income			300.0	200.0	200.0	200.0	900.0
Franchise Tax Board	MR	Rejection of Governor's Budget Proposal to Permanently Limit Net Operating Losses to 80 Percent of Taxable Income			-300.0	-200.0	-200.0	-200.0	-900.0
California Department of Tax and Fee Administration	GB	Eliminate Bad Debt Deduction for Lenders and Retailers Affiliates			2.5	10.0	10.0	30.3	52.8
Franchise Tax Board	GB	Conform to 2022 Consolidated Appropriations Act Changes for Charitable Conservation Easements			70.0	34.0	25.0	21.0	150.0
Franchise Tax Board	GB	Eliminate Intangible Drilling Cost Expensing Tax Expenditure			11.0	7.8	7.5	7.5	33.8
Franchise Tax Board	GB	Eliminate Percentage Depletion Tax Expenditure for Fossil Fuels			11.0	9.4	9.3	9.2	38.9
TOTAL			**0.0**	**0.0**	**994.5**	**5,561.2**	**5,951.8**	**3,668.0**	**15,275.5**

NOL and Limits business tax credits. The May Revision proposes to temporarily suspend Net Operating Losses (NOL) use for medium and large businesses and limits business credit use to $5 million per year for tax years 2025, 2026, and 2027. Businesses with less than $1 million in taxable income will be exempt from the NOL suspension and all businesses will be able to use their credits up to $5 million per year. The solution is subject to a trigger whereby if cumulative cash receipts for the Big 3 taxes exceed the 2024 Budget Act forecast by three percent or more from May 2024 to April 2025, it will not take effect. If it takes effect in May 2025, this NOL suspension and credit limitation would exactly mirror the criteria and parameters of the 2020 and 2021 NOL suspension and credit limitation.

The May Revision also proposes to reject the January proposal on NOLs.

Bad Debt. The Governor's budget proposes trailer bill language to eliminate the sales and use tax deduction and refund for a lender or retailer's affiliate for sales and use tax previously paid by a retailer on accounts found worthless and charged off for income tax purposes (subsequently referred to as bad debt) beginning on January 1, 2025. Retailers would remain eligible to claim such deductions or refunds.

The administration estimates that the proposal would raise General Fund revenues by $25 million in 2024-25, and by $51 million in 2025-26, and ongoing. They estimated that revenues for other funds, which support various local programs, would increase by roughly $30 million in 2024-25, and $60 million in 2025-26, and ongoing.

Charitable Conservation Easements. The Governor's budget includes trailer bill language to conform California law to the 2023 federal changes in the Consolidated Appropriations Act (CAA), limiting deductions for charitable conservation easements to two and a half times the investment cost for the purchaser, and disallowing the deduction for any taxpayer who has previously engaged in fraud.

The administration estimates this will raise $55 million in 2024-25, and $25 million annually thereafter.

Eliminate Oil and Gas Direct Tax Subsidies. The Governor's budget proposes three trailer bills that eliminate oil and gas direct tax subsidies as follows:

- Proposes to eliminate accelerated Intangible Drilling Costs (IDC) expensing for oil and gas wells. The administration estimates that this proposal would generate $7 million in 2024-25 and the next 3 years. Since this proposal shifts some tax collections from later years into earlier years, the annual savings likely would be somewhat lower in the following years.

- Proposes to eliminate percentage depletion for oil, gas, coal, and oil shale. Percentage depletion would remain for other minerals, such as sand, gravel, gold, and lithium. The administration estimates that this proposal would generate $15 million General Fund in 2024-25 and $10 million ongoing.

- Proposes to eliminate the Enhanced Oil Recovery (EOR) cost credit. The administration does not assume any fiscal effect associated with this proposal over the next few years since crude oil prices are expected to remain above the price threshold used to determine when businesses can claim the credit.

Other May Revision Tax Proposals

- **Apportionment Factor Fix.** The May Revision proposes trailer bill language to clarify existing law that when a corporation receives income that is excluded from taxable business income, then it must exclude this income from its apportionment factor formula.

  Multi-state and multi-national corporations pay taxes in California by computing how much of their taxable income is allocated to California using an apportionment factor, which represents the share of business activity a firm conducts in a state divided by its total business activity in the U.S. or in the world. A lower California apportionment factor will, all else equal, lead to lower California tax liability.

  This proposal is declaratory of existing law and expressly states that when a corporation receives income that is excluded from taxable business income, it must exclude this income from its sales factor. This aligns with the FTB's 2006 legal ruling and longstanding guidance on the matter, providing clear statutory authority and guidelines to taxpayers on how to determine what income should be included in their sales factor.

  The FTB estimates that, without action, around $1.3 billion in refunds are at-risk based on similar tax filings from prior years, and there are additional annual prospective refunds of around $200 million due to lower apportionment factors for multi-state and multi-national firms.

- **California Disaster Tax Relief.** The May Revision proposes trailer bill language to allow the Director of Finance to determine whether a taxpayer is affected by a state of emergency, when determining whether the postponement of certain tax-related deadlines applies to a taxpayer.

  This proposal would instead require the Director of Finance to determine whether a taxpayer is affected by a state of emergency and allow federal income tax laws, relating to the postponement of certain tax-related deadlines, to apply to an impacted taxpayer during an additional relief period that requests relief, as specified.

An impacted taxpayer means a taxpayer who, among other things, requests relief, as specified below, and who is required, upon request, to submit supporting documentation related to the declared disaster, as specified.

According to the Administration, this proposal would provide the state additional tools to determine and extend tax deadline postponement to taxpayers who are genuinely impacted by a natural disaster or other emergency and prevent the issues that arose when the IRS extended tax deadlines to file for the 2022 tax year multiple times throughout 2023.

- **Income Threshold Fix.** The Governor's May Revision proposes trailer bill language that would align the maximum earned income thresholds for the California Earned Income Tax Credit (CalEITC), the Young Child Tax Credit (YCTC), and the Foster Youth Tax Credit (FYTC). This technical fix would ensure the YCTC and FYTC maximum earned income thresholds are adjusted to that of the CalEITC. Implementing this change will reduce confusion among tax payers and simplify the process of claiming these credits

Assembly Considerations

Staff commends the administration for developing a practical solution to the extended IRS tax extensions of recent years. The proposed trailer bill balances the executive branch's power to decouple state tax deadlines from extended federal extensions in the future with the need to provide those most harmed by disasters with needed tax relief.

With regard to the NOL deductions and tax credits, this proposal is one of the largest budget balancing proposals in the May Revision. Not adopting it requires more difficult cuts, alternative tax increases, more borrowing, and/or more use of reserves. Some members, however, note that the repeated use of this suspension policy may harm technology and biotechnology companies' efforts to plan future research efforts in California.

Earlier this year, the LAO provided alternative revenue options to explore. The Legislature may want to explore two additional options. (Staff notes that about 40 percent of the added state General Fund revenues from the proposals automatically would go to schools and community colleges.)

1. **Single Sales Factor for Financial Institutions**. Current law requires multistate firms to use a mandatory single sales factor tax policy, however agricultural, extraction, and financial firms were exempted from this change and remain on an equally weighted three-factor formula (property, payroll, and/or sales that occurred in that state). Amending statute to require multi-state financial firms to use a mandatory single sales factor tax policy instead of the equally weighted three-factor formula, beginning with taxable year 2024 is estimated to raise $260 million in revenue in 2024-25, and between $220 and $230 million ongoing. In general, a California–based corporation, one with significant payroll and property in the state, would be able to reduce its tax bill by switching from the

current three-factor apportionment formula to a single sales factor apportionment formula. In contrast, an out–of–state corporation that has relatively high sales in California compared to its shares of property and payroll in California would not benefit from switching to the single sales factor apportionment formula. This change would remove an incentive for financial firms to physically locate in other states, and instead promote job growth within California.

2. **Eliminate the Subscription Periodicals Sales Tax Exemption.** Magazine subscriptions are exempt from sales tax. However, magazines sold at stores are taxed, as are subscriptions to daily newspapers. There is no clear rationale for this discrepancy. It is anticipated that this could generate $10 million in revenues.

Major Broadband Proposals

Middle-Mile Broadband Initiative

The state is building, leasing, and purchasing middle-mile broadband infrastructure to create a statewide, open-access middle-mile network deployed primarily along the state's highways and other rights of way. This network is expected to be available to all public entities, Internet service providers (ISPs), nonprofit organizations, and other entities to connect to and deliver high-speed Internet access. The middle-mile network project is led by the California Department of Technology (CDT) and its third-party administrator, GoldenStateNet, in consultation with the California Public Utilities Commission (CPUC) and the California Department of Transportation (Caltrans).

The charts below outline the broadband funding, including for the Middle-Mile network, as of the 2023-24 Budget Act, and the Middle-Mile Network projects with encumbered funding.

Broadband Infrastructure Spending Plan as of the *2023-24 Budget Act*

(In Millions)

		Funding Source		
Program or Project	**Fiscal Year**	**GF**	**FF**	**TF**
Middle-Mile Network	Prior Years	$887[a]	$2,363[b]	$3,250
	2023-24	300	73[c]	373
	2024-25	250	—	250
	2025-26	—	—	—
	2026-27	—	—	—
Subtotals		($1,437)	($2,436)	($3,873)
Last-Mile Projects Grants	Prior Years	$647[d]	$550[e]	$1,197
	2023-24	253	—	253
	2024-25	200	—	200
	2025-26	200	—	200
	2026-27	150	—	150
Subtotals		($1,450)	($550)	($2,000)
LLRF	Prior Years	—	—	—
	2023-24	$175	—	$175
	2024-25	300	—	300
	2025-26	275	—	275
	2026-27	—	—	—
Subtotals		($750)	(—)	($750)
All Programs and Projects	Prior Years	$1,534	$2,913	$4,447
	2023-24	728	73	801
	2024-25	750	—	750
	2025-26	475	—	475
	2026-27	150	—	150
Totals		**$3,637**	**$2,986**	**$6,623**

[a] Pursuant to Control Section 11.96 of the *2022-23 Budget Act*, the Department of Finance shifted $887 million for the middle-mile network from ARP fiscal relief funds to GF in 2021-22.

[b] The remaining $2.363 billion in FF for the middle-mile network in 2021-22 is state ARP fiscal relief funds.

[c] Chapter 189 of 2023 (SB 104, Skinner) appropriated a $73 million award of federal funds in 2023-24 from the IIJA's Enabling Middle Mile Broadband Infrastructure Program.

[d] Pursuant to Control Section 11.96 of the *2022-23 Budget Act*, the Department of Finance shifted $522 million for last-mile projects from ARP fiscal relief funds to GF in 2021-22.

[e] The remaining $550 million in FF for last-mile project grants in 2021-22 is the state's allocation from the ARP's Coronavirus Capital Projects Fund.

GF = General Fund; FF = federal funds; TF = total funds; LLRF = Loan Loss Reserve Fund; ARP = American Rescue Plan; SB = Senate Bill; and IIJA = Infrastructure Investment and Jobs Act.

Middle-Mile Network Projects With Encumbered Funding

Project Name	Delivery Method	Miles	Estimated Cost (In Millions)	Encumbered Funding (In Millions)		
				TF	GF	FF
CVIN	Lease	2,522	$715	$715	$427	$288
Various	Standalone Caltrans Construction	1,800[a]	950	500[b]	—	500
Lumen	Joint-Build	1,186	257	257	—	257
Lumen	Lease	710	141	141	—	141
Digital 395	Purchase	435	31	31	31	—
Arcadian #1	Joint-Build	310	134	134	—	134
Arcadian #2	Joint-Build	280	171	171	—	171
Arcadian #3	Joint-Build	255	127	127	—	127
Zayo	Joint-Build	193	13	13	—	13
TPN	Lease	172	40	40	40	—
Siskiyou Telephone Company	Joint-Build	165	52	52	—	52
Arcadian #5	Joint-Build	117	38	38	—	38
Boldyn	Lease	81	79	79	—	79
Arcadian #4	Joint-Build	44	17	17	—	17
Vero	Joint-Build	24	7	7	—	7
Hoopa	Joint-Build	23	10	10	—	10
Subtotals		**8,317**	**($2,782)**	**($2,332)**	**($498)**	**($1,834)[c]**

Additional Costs	Estimated Cost (In Millions)	Encumbered Funding (In Millions)		
		TF	GF	FF
Administration	$250	$250	$8	$242
Conduit, Fiber and Vaults[d]	234	234	172	62
Electronics	215	—[e]	—	—
Huts[f]	69	69	61	8
Subtotals	**($768)**	**($553)**	**($241)**	**($312)**
Totals	**$3,550**	**$2,885**	**$739**	**$2,146**

[a]The exact number of miles of standalone Caltrans construction projects that can be funded with the $500 million in encumbered federal ARP fiscal relief funds is unknown. The 1,800-mile estimate also assumes at least $450 million GF, all of which is appropriated yet unencumbered, as well as an anticipated appropriation of $250 million GF in 2024-25.

[b]The $450 million difference between encumbered funding and the estimated cost of the standalone Caltrans construction projects is expected to be covered by appropriated yet unencumbered GF.

[c]This FF subtotal does not include the $73 million award of FF in 2023-24 from the IIJA's Enabling Middle-Mile Broadband Infrastructure Program.

[d]Conduit are physical tubes that encase fiber-optic cables. Vaults are protective shelters for network equipment that are close to the served area or household.

[e]Bids for network electronics remain under review, so no funding is encumbered yet for these purchase orders. CDT expects to encumber appropriated ARP fiscal relief funds for these costs once bids are reviewed.

[f]Huts are protective shelters for network equipment used for middle-mile broadband infrastructure.

TF = total funds; GF = General Fund; FF = federal funds; CVIN = Central Valley Independent Network; Caltrans = California Department of Transportation; IIJA = Infrastructure Investment and Jobs Act; ARP = American Rescue Plan; and CDT = California Department of Technology.

In its January budget, the administration requested $250 million in 2024-25 and $1.25 billion in 2025-26 from the General Fund to fund completion of the Middle Mile Broadband Initiative network and make 36 administratively established positions permanent. The Department also requested budget bill language allowing up to $500 million General Fund to be allocated earlier in 2024-25 should the MMBI progress faster than anticipated.

The administration has proposed a significant shift in approach for the Middle-Mile network at May Revision. Specifically, the administration retracted its request for $1.5 billion, and instead proposes provisional budget language to allow the Director of Finance to augment funding up to $1.5 billion General Fund upon notification to the Joint Legislative Budget Committee. Although the Administration recognizes that additional funding may become necessary in the future, it believes it can meet most of the middle-mile commitments on the network – particularly with upcoming RFI2 solicitation bids that seek to identify joint-build construction projects, leases, and/or purchases in place of the remaining standalone Caltrans construction projects.

Assembly Considerations

Staff notes that there are outstanding questions as to which segments of the remaining Middle-Mile network are targeted for completion, and what is the Administration's strategy and approach on how to prioritize these remaining segments. Decisions on Middle-Mile funding pose a challenge without this information. Additionally, the Administration has not yet shared with the Legislature what alternative has been developed to complete the Middle-Mile network without the $1.5 billion that was originally requested in the January budget.

In its recommendations on broadband infrastructure, the LAO recommends that the Legislature reject the revised provisional budget bill language that would allow administration approval of an additional $1.5 billion General Fund for the middle-mile network in 2024-25 as there is: (1) no funding set aside to support the augmentation, (2) incomplete information about the standalone construction projects that would be funded, and (3) limited legislative oversight afforded by written notification of the Joint Legislative Budget Committee for such a large request. Instead, the LAO recommends the Legislature approve provisional budget bill language with no additional funding that requests, at a minimum, (1) more detailed information about the standalone construction projects funded by the current spending plan, and (2) a business plan for the middle-mile network that explains how it will be maintained and operated going forward.

Major Labor Proposals

Labor and Workforce Development Program Reductions

The Governor's budget proposes several funding reductions for various workforce and development programs. Those funding changes are outlined below:

**Note: the list below does not include labor and workforce development programs that were acted upon in the April 2024 budget early action package.*

Employment Development Department

California Jobs First (Formerly CERF): The California Jobs First program is an inter-agency partnership between the Labor and Workforce Development Agency, the Office of Planning and Research, and the Governor's Office of Business and Economic Development to create regionally governed investments focused on job creation adapted to climate change. The program was allocated a total of $600 million to be used for workforce investments in 13 regions across California. Approximately $286 million of this fund has been used for the planning phase of the program and to support ready-to-launch economic development pilot projects within the 13 regions.

The April 2024 early action agreement delayed $275 million from 2021-22 and instead included $91.7 million for each year between 2024-25 and 2026-27. The May Revision reduces funding for the program by $150 million over three years ($50 million General Fund reduction in each of 2024-25, 2025-26, and 2026-27) and reverts $25 million appropriated in the 2021 Budget Act.

California Workforce Development Board

California Youth Leadership Corp. The 2022 Budget Act included $20 million General Fund in 2022-23 and $20 million General Fund in each of 2023-24 and 2024-25 as advance payment and support to the Emerald Cities Collaborative for CYLC for community change learn-and-earn career pathway programs at 20 selected community colleges over four-year period. The May Revision reduces funding for this program by $20 million in 2024-25.

Low Carbon Economy Grant Program: The 2022 Budget Act appropriated $15 million General Fund annually for over three years, totaling $45 million for the Low Carbon Economy Initiative. This program supports job creation in various sectors, including zero emission bus manufacturing, energy storage, food and agriculture, fossil fuel transition, clean transportation, forestry, utility line tree-trimming, and offshore wind. The 2023 Budget Act shifted $15 million of funding to the Greenhouse Gas Reduction Fund. The 2024-25 budget proposes cutting the program by $15 million General Fund, leaving $30 million for the program.

High Road Training Partnership for Health and Human Services: The 2022 Budget Act allocated $135 million over 3 years, to recruit, train, hire, and advance California's health and human services sectors. Funding is awarded through regional grants, with partners including community colleges, workforce boards, employers, and non-profit organizations. The 2024-25 budget proposes reducing the program's budget by $45 million General Fund, maintaining $90 million over two years for the program.

Department of Industrial Relations:

Women in Construction Priority Unit: The Governor's January budget proposed to reduce funding for the unit by $5 million General Fund in 2024-25 and ongoing and maintain the program at $10 million General Fund ongoing. The May Revision eliminates the program by reducing funding for the Unit at DIR by $15 million on an ongoing basis.

Apprenticeship Innovation Fund: The Division of Apprenticeship Standards (DAS) at DIR administers the program, which provides grants, reimbursements, or other funding for the expansion of non-traditional apprenticeship programs and supports additional apprentice activities such as training. The 2024 early action agreement between the Governor, Assembly, and Governor included the Governor's January proposal to delay $40 million General Fund in 2024-25 and spread this funding over 2025-26 and 2026-27 fiscal years. The May Revision proposes to turn this delay into a reduction of $40 million General Fund.

California Youth Apprenticeship Program: The 2022 Budget Act provided $65 million General Fund over three years to establish the Youth Apprenticeship Grant Program to develop new, or expand on existing apprenticeship programs for 16–24-year-olds who are unhoused, in the welfare, or juvenile justice system or otherwise facing barriers to labor market participation. The Governor's January budget proposed to delay $25 million for the program to 2025-26. The May Revision proposes to turn this delay into a reduction of $25 million General Fund.

Unemployment Insurance

California's Unemployment Insurance program is financed through employers, who pay a payroll tax into the state's UI trust fund. Under existing state tax and benefit rules, the UI trust fund does not build large enough reserves in normal times to cover the increase in claims during a recession. During recessions, states may borrow from the federal government to continue payment benefits if state UI funds are insufficient. These loans must be repaid, with interest, at a later time. The loan principal is repaid by automatic increases in the federal UI tax rate employers pay, and the interest has historically been paid from the General Fund. However, in recent years, the state budget began looking at special funds to finance a portion of the federal interest payment. Prior to the pandemic, at the start of 2020, the state's UI trust fund held $3.3 billion in reserves. Despite these reserves, the state's UI trust fund became insolvent during the summer of 2020, a few months following the start of the pandemic and associated job losses.

California, like many other states, used federal loans to continue paying benefits during the pandemic. In total, the state needed to borrow about $20 billion from the federal government, roughly twice the amount the state borrowed for UI benefits during the Great Recession of 2008. To repay the federal loans, the federal UI payroll tax rate on employers increase slightly each year until the loans are repaid.

The Governor's 2024-25 budget includes $331 million one-time funding to pay the annual interest payment on the state's Unemployment Insurance loan balance. Of that amount, $231 million is from the General Fund, and $100 million is from the Employment Training Fund. The Employment Training Fund (ETF) is funded from contributions from employers, equal to 0.1 percent of wages, with the contributions generally used to reimburse the cost of employer-driven training for incumbent workers and funding training needed by unemployed workers to re-enter the workforce.

The May Revision increased this estimated payment by $153 million General Fund one-time. This update increases the total proposed Unemployment Insurance loan interest payment to $484 million ($384 million General Fund and $100 million Employment Training Fund). In addition, the May Revision proposes a one-time $50 million Employment Training Fund payment to support the state's UI loan interest payment in 2025-26.

Major Employee Compensation Proposals

Telework Stipends

The Ralph C. Dills Act (Dills Act) establishes collective bargaining for state employees. Under the Dills Act, there are different types of labor agreements that the state and employee representatives enter into. The most significant of these types of agreements is a memorandum of understanding (MOU). The MOU is the labor contract that establishes the vast majority of working conditions and terms of employment for state employees. Other types of labor agreements are addenda to the MOU, including a type of agreement referred to as a side letter. A side letter is a labor agreement that addresses a specific issue beyond what is included in the MOU.

Across 2021 and 2022, the state and 17 of the state's 21 bargaining units entered into side letters establishing a stipend for teleworking state employees. Under those agreements, employees who telework more than 50 percent of their time receive $50 per month and employees who telework more than 0 percent but less than 50 percent of their time received $25 per month. The side letter agreements specified that after the side letter went into effect, "no reimbursement claims will be authorized for utilities, phone, cable/internet, or other telework incurred costs."

In January, the Governor's budget proposed eliminating the telework stipend beginning 2024-25 established under the side letters. At the time, the administration indicated that the state will attempt to negotiate with each bargaining unit to eliminate the stipend.

At May Revision, the administration submitted language for a trailer bill that would effectively eliminate the telework stipend program for all 17 bargaining units effective for the July 2024 pay period. The trailer bill notes that the "state shall bargain the impact of the elimination of the Telework Stipend Program"

Elimination of Vacant Positions

As part of the January budget, the Administration proposed to identify one-time spending reductions related to savings for vacant positions across executive branch state departments – a proposal adopted in the budget early action package.

At May Revision, the Administration revised the proposal to make the reduction permanent. According to the Administration, the Department of Finance will work with agencies and departments in the fall on the appropriate budget reductions starting in 2024-25 and will eliminate approximately 10,000 positions starting in 2025-26 and ongoing. The 10,000 positions is the approximate number of positions needed to capture the estimated, ongoing savings related to vacant positions. However, the 10,000 positions estimate is subject to change based on actual implementation of this proposal, as each department may achieve the same amount of savings by eliminating a smaller number of high-cost positions or a larger number of low-cost positions.

Assembly Considerations

Telework Stipends: Staff notes that collective bargaining for state employees is a process exclusively negotiated between the Administration (represented by the California Department of Human Resources) and the respective bargaining units representing state employees. Although final MOUs are submitted to the Legislature for consideration and approval, the Legislature has rarely modified or interfered with agreed-upon labor agreements. The subcommittee has expressed concerns during its May 16 hearing that the proposed trailer bill would effectively override side letter agreements negotiated between the Administration and the 17 bargaining units receiving telework stipends.

The LAO noted in its analysis that the elimination of the telework stipend would achieve $26 million General Fund savings. This figure represents less than one-quarter of 1 percent of the state's General Fund payroll costs associated with these bargaining units and the associated excluded employees. While the cost of the telework stipend is small, based on anecdotal evidence, the ability to work remotely has been very popular among state workers and increasing in-office work poses challenges. This suggests that bargaining might be difficult and that the parties might not come to an agreement. Imposing the elimination of the stipend—if no agreement is reached—would have negative downstream effects on labor relations. Given all of this, implementing the Governor's proposal seems disproportionately difficult relative to the modest savings that would be achieved.

Vacant Positions: The subcommittee has expressed concerns with the proposal as it relates to state departments who already have a high vacancy rate and historically had issues with staff recruitment, hiring, and retention. In response to these concerns, the Administration noted that only a portion of vacant position funding and positions will be captured to allow departments flexibility for critical position hiring. The Administration's proposal assumes critical public safety and 24-hour operational requirements are exempted, and anticipates working with departments to identify any other necessary exemptions. Of note, the proposal does not constitute the implementation of a hiring freeze, and departments will retain funding and position authority to continue hiring positions to fill all vacancies not targeted through this budget solution.

The LAO notes that the proposed process to reduce positions excludes the Legislature. Under the administration's proposal, the Legislature would have no role in determining how to allocate reductions. Instead, the reductions would be made through an internal administrative process. As a result, any reductions would reflect the administration's priorities. The proposed process gives no deference to legislative priorities. Further, the proposal has no clear mechanism to inform the Legislature of any reductions made through the administrative exercises.

Major Reorganization May Revision Proposals

Office of Planning and Research Reorganization

The Office of Planning and Research includes four main budget programs: the State Planning and Policy Development that houses most of core planning and research functions for the Governor's Office and the Administration, as well as the Racial Equity Commission and Youth Empowerment Commission; the California Strategic Growth Council, which coordinates and provides direct grant funding for various sustainability projects; the Office of Community Partnerships and Strategic Communications that implements public awareness campaigns; and California Volunteers, a program aimed to increase the number of Californians involved with service and volunteering throughout the state.

Due to the growing size and responsibilities of OPR over the years, the Administration proposes a rebranding and "net-zero" reorganization of OPR's current structure. This includes rebranding OPR to the Governor's Office of Climate and Land Use Innovation (GO CALI), establishing the new Governor's Office of Service and Community Engagement (GO SERVE), and transferring several programs starting in 2024-25 to various other departments, as outlined below:

New Governor's Office of Service and Community Engagement (GO SERVE). This new office will house California Volunteers, the Office of Community Partnerships and Strategic Communications, and the Youth Empowerment Commission.

California Initiative to Advance Precision Medicine to CalHHS. The Initiative supports research demonstration projects and connects health and medicine stakeholders from across California. Current state funded research projects include Adverse Childhood Experiences, Cancer Disparities, and Depression Research. CIAPM is currently budgeted through 2028-29 and the remaining balances for each of the initiatives listed will be transferred to the Health and Human Services Agency.

California Jobs First to Go-Biz. As noted in the Labor and Workforce Development section, the California Jobs First program is an inter-agency partnership between the Labor and Workforce Development Agency, the Office of Planning and Research, and the Governor's Office of Business and Economic Development to create regionally governed investments focused on job creation adapted to climate change. OPR's CA Jobs First received funding from the Employment Development Department to support the program and the remaining balance of these funds will be transferred to GO-Biz.

Zero Emission Vehicle Program to Go-Biz. OPR provides support towards the deployment of ZEVs by providing resources to local jurisdictions and the public, such as the ZEV Community Readiness Guidebook and the ZEV Action Plan. The ZEV Action Plan outlines the strategy to help expand ZEVs within public bus fleets and to reduce cost barriers to ZEV adoption for freight vehicles and public buses. This program received a one-time appropriation, and the balance of this appropriation will be transferred to Go-Biz.

OPR Programs: Budget Reductions

The May Revision also proposes the following reductions to programs currently administered by OPR:

- Youth Corps Program: Proposes a decrease of $10 million ongoing.
- Neighbor-to-Neighbor Program: Proposes a decrease of $5 million in 2024-25 and $10 million in 2025-26.
- Californians for all College Service Program: Proposes a decrease of $10 million in 2024-25 and 2025-26.
- Office of Community Partnership and Strategic Communications: Proposes a decrease of $42 million in 2024-25 and 2025-26.
- Youth Empowerment Commission: Proposes a decrease of $1.5 million in 2027-28 and ongoing.

- California Education Learning Lab: Proposes a decrease of $5.5 million in 2024-25 and 2025-26, and $4 million in 2026-27 and ongoing.

- Golden State Awards: Proposes reverting $9.9 million for the Golden State Awards program included in the 2022 Budget Act.

Arts Council Reorganization Under Go-Biz. The May Revise proposes to establish the California Arts Council as a program within Go-Biz. According to the Administration, this reorganization would enable the California Arts Council to use Go-Biz' administrative operations, particularly in grant administration.

Under this reorganization, the current structure of the California Arts Council would remain intact, retaining its 11 members appointed by the Governor, the Speaker of the Assembly and Senate Rules Committee.

Assembly Considerations

In both the OPR and Arts Council proposals, the Administration notes that these restructurings are "net-zero" reorganizations and would not result in an overall increase or decrease in operating budgets. As both proposals were unveiled at May Revision, the Legislature has been provided little time to fully review the potential efficiencies or long-term impacts of these major department reorganizations. While some of elements of the reorganizations appear straightforward – such as transferring the California Initiative to Advance Precision Medicine to CalHHS – other pieces of the proposals, such as placing the California Arts Council under Go-Biz, merit additional analysis. As both reorganization proposals are "net-zero" restructurings and do not yield any savings in the context of the budget deficit, there is not urgency for the Legislature to approve these proposals immediately. The subcommittee may wish to discuss the appropriate timing and the appropriate avenue to consider these reorganizations.

Other Significant General Government Proposals in Governor's Budget and May Revision

On May 16, 2024, Subcommittee 5 heard the Governor's May Revision proposals. A summary of all those proposals can be found here. The following highlights some of those key proposals below.

Governor's Office of Business and Economic Development (Go-Biz). The GO-Biz includes a delay in the amount of $100 million and reductions totaling $403.5 million from 2022-23 to 2025-26. (Note: The I-Bank Clean Energy Transmission was discussed in Sub. 4).

GO-Biz Budget Solutions

Title	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
City of Fresno Public Infrastructure Plan (Delay)				100	-100	
Infrastructure State Revolving Fund			25			
Performing Arts Equitable Payroll Fund		12.5				
Small Agricultural Business Drought Relief Grant Program		5				
IBank Clean Energy Transmission	200	25				
Small Business Technical Assistance Expansion Program			13	13		
California Competes Grant Program		10	50			
Local Government Budget Sustainability Fund		50				

Department of Financial Protection and Innovation (DFPI). The May Revision includes resources to implement the following chaptered bills:

- **Venture Capital Companies Reporting Workload**. Provides $1.6 million one-time in 2024-25 (General Fund) and $884,000 ongoing (Financial Protection Fund) to implement venture capital company reporting requirements, as required by Chapter 594 of 2023 (SB 54, Skinner). The proposal also includes trailer bill language that makes statutory changes to SB 54, such as changing the administering agency from the Civil Rights Department to DFPI and related enforcement changes.

- **Digital Financial Asset Law Workload.** Provides $7.9 million in 2024-25 (increasing to $11.4 million in 2026-27 and ongoing) from the Financial Protection Fund to regulate crypto assets, as required by Chapter 792 of 2023 (AB 39, Grayson).

Arts Council. The May Revision reduces funding for Arts grant funding by $10 million ongoing, leaving $14.3 million yearly for Arts grant programming. A full breakdown of Arts grant programs funded in 2023 was provided in the April 16 Subcommittee 5 agenda.

Government Operations Agency: Generative Artificial Intelligence. Generative AI (GenAI) represents a category of pretrained AI models capable of producing new synthetic content. The California State Administrative Manual — the reference resource for the executive branch's statewide management policies — defines GenAI as "class of AI models that emulate the structure and characteristics of input data in order to generate derived synthetic content. This can include images, videos, audio, text, and other digital content."

In response to the rapidly evolving nature of GenAI technology, Governor Newsom issued an Executive Order on September 6, 2023 directing state departments to study the development, use, and risks of artificial intelligence technology throughout the state and to develop a process for the evaluation, procurement, and deployment of AI within state government.

The administration provided an update on its GenAI efforts at the Subcommittee's April 16 hearing. In this update, the Administration discussed issuing five "Request of Innovative Ideas," or RFI2, to competitively solicit, bid, and procure GenAI pilot solutions. Four state entities will be piloting these GenAI solutions: the California Department of Tax and Fee Administration (CDTFA), the California Department of Transportation (CalTrans), the California Health and Human Services Agency (CalHHS), and the California Department of Public Health (CDPH).

To meet the procurement goals laid out by the Executive Order, the California Department of Technology has established a GenAI "sandbox" to conduct pilots of GenAI projects. This sandbox environment aims to provide a safe digital environment to test various applications of GenAI for state government operations.

On May 6, 2024, the Administration announced the execution of various contracts for its GenAI proof-of-concept pilots. The following entities have received contracts: Deloitte Consulting, LLP; Accenture, LLP; SymSoft Solutions, LLC; Ignyte GroupCA; and INRIX. These vendors will receive a minimal payment of $1.00 to execute the proof-of-concept in the CDT-managed sandbox.

Cannabis Funding Loan to the General Fund

California deposits cannabis tax revenues into the Cannabis Tax Fund. Proposition 64 of 2016 requires the Cannabis Tax Fund to support three types of activities, often referred to as "allocations":

- Allocation 1—Regulatory and Administrative Costs. First, revenues pay back certain state agencies for any cannabis regulatory and administrative costs not covered by license fees.
- Allocation 2—Specified Allocations. Second, after regulatory and administrative costs are covered, revenues go to certain research and other programs, such as researching the effects of cannabis and the effects of the measure.
- Allocation 3—Percentage Allocations. Third, these revenues go to three broad types of activities: 60 percent of Allocation 3 goes to youth programs related to substance use education, prevention, and treatment; 20 percent for environmental programs; and 20 percent for law enforcement. Unlike the other allocations, funding for Allocation 3 comes from tax receipts from the prior year. Proposition 64 does not allow the administration to change the share of revenue allocated to each of the three Allocation 3 categories, although the measure loosens these restrictions starting in 2028. However, it generally authorizes the administration to choose how to allocate funding among various eligible activities within each of the three Allocation 3 categories (youth substance use programs, environmental programs, and law enforcement).

A detailed breakdown of funding allocations, expenditures, and carryovers for Allocation 1, 2 and 3 is provided in the March 12 Subcommittee 5 hearing agenda addendum.

To address the budget deficit, the April budget early action package included a budgetary loan of $100 million from the Board of State and Community Correction's (BSCC) Cannabis Tax Fund subaccount to the General Fund from currently unobligated resources. The repayment plan is proposed to be $50 million in 2026-27 and the remaining $50 million 2027-28. BSCC primarily uses cannabis tax revenues to provide grant funds to local governments that assist with law enforcement, fire protection, or other local programming to address public health and safety associated with the implementation of cannabis statutes and regulations. As cannabis tax funds are deposited into a subaccount, the administering entity may not spend the entire money within a year. Any unspent money is then rolled over to the next fiscal year. The BSCC has accumulated a considerable amount of such carryover funds, and as a result, the Administration notes that the $100 million loan does not impact BSCC's funding for its grant program. Specifically, the Governor's 2024-25 budget provides $63.7 million of cannabis tax revenues for BSCC's public safety services grant program. When including unused carryover funding from prior years, the BSCC total accrued reserves as of 2024-25 is approximately $260 million. Accounting for the BSCC loan to the General Fund, the BSCC grant program would have a remaining $160 million available for its public safety grant program. Of note, while BSCC expenditures for the grant program has fluctuated over the years, it has reached a high of $93.9M spent in 2023-24.

At May Revision, the Administration proposes allocating and additional $75 million loan from the BSCC Cannabis Subaccount to the General Fund in 2024-25, to be repaid in 2025-26. The loan from the BSCC Cannabis subaccount to the General Fund would total $175M.

Department of Real Estate Fee Increase

Special-funded consumer protection departments, such as the DRE, levy various fees that are determined by statutes. Generally, these statutes define both a minimum baseline fee and a maximum limit that the department cannot exceed. To adapt to changing financial circumstances, departments have the authority to adjust their fees within these statutory limits through regulatory changes. Changing fees via regulations does not require legislative review and approval. However, if a department seeks to raise its fees beyond the statutory maximum, it must undergo the legislative process to amend the corresponding statutes.

The statutory maximum for DRE fees was last raised in 1997. Over the years, DRE fees have been increased and decreased multiple times, to ultimately be raised to their statutory maximum in 2009. In 2022-23, DRE's financial projections identified a declining fund balance, with revenues not keeping pace with the cost of operations. DRE subsequently conducted a fee study to evaluate the fee amounts to support its operations and understand current service levels and the cost of providing those services.

According to DRE, it is only recovering 86 percent of its costs to operate. The Department notes that without a change in fees, current projections estimate the Department's special fund, known as the Real Estate Fund, will have a negative fund balance of $15,946,000 in 2025-26, growing to $35,445,000 in 2026-27. Because DRE's current fees are set to their statutory maximum, the Department is requesting trailer bill to increase fees. The current proposal would both increase the baseline minimum fee as well as set new statutory maximums. Those statutory maximums are approximately 50 percent higher than the current level needed. The Department's full list of proposed new fees is included on the Subcommittee's website.

Assembly Consideration

Go-Biz. Advocates sent in over 2,000 letters in opposition to the cuts to the Technical Assistance Program (TAP). The May Revision cuts the TAP program by 50 percent or from $26 million to $13 million. According to the advocates, the $13 million cut to TAP and CIP "will gut the ecosystem that currently supports over 100,000 businesses with training and consulting. These fundamental programs show consistent year-over-year results, are net-positive in sales and income tax revenue-generating, and leverage over $35 million in federal funding that could be lost."

DFPI. The LAO recommends that the DFPI has funded the start-up costs of other programs through the Financial Protection Fund and then recouped those costs through the program's revenue deposited into the Financial Protection Fund. The Financial Protection Fund has a sufficient fund balance to absorb this one-time cost for the implementation of SB 54 in 2024-25, and doing so would reduce pressure on the General Fund, which is important in light of the state's budget condition. Additionally, the LAO notes that this proposal includes trailer bill language that makes statutory changes to SB 54.

Generative Artificial Intelligence. Future costs associated with the Administration GenAI efforts are uncertain at this time. While the RFI2 solicitation bids note that, "at the State's sole discretion, and subject to budget appropriations, the State may award final contract(s) and Solution Provider(s) will receive payment for goods and services rendered in accordance with the terms of the contract(s)," it is unclear if the Administration intends to fund future GenAI contracts out of existing appropriations. Additionally, it is unclear at what juncture will the Legislature be able to review such contracts. As noted at the hearing, the California Department of Technology has already reported minor ongoing costs associated with monthly usage charges from cloud vendors related to the storage and computing resources used during proof-of-concept activities. These costs are to be paid for by the agencies and departments participating in the RFI2.

The subcommittee may wish to consider budget language that would clarify that the administration may not expand spending for these or similar projects without explicit legislative approval in future budget acts.

Cannabis Funding Loan to the General Fund: In its review of Allocation 3 funding, staff notes that several other Cannabis subaccounts have built significant reserve funding. The subcommittee may wish to inquire if this surplus funding is planned to be use by these Departments in 2024-25. If not, the subcommittee may wish to ask if the Administration has considered using any other Cannabis Allocation 3 fund source with a significant surplus to loan to the General Fund.