AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

Assemblymember Juan Arambula, Chair

TUESDAY, APRIL 17, 2007, 1:30 PM
STATE CAPITOL, ROOM 447

CONSENT CALENDAR

ITEMS TO BE HEARD

ITEMS ON CONSENT

ITEM 8180 PAYMENTS TO COUNTIES FOR HOMICIDE TRIALS

The Government Code provides for reimbursement to counties for the extraordinary costs associated with homicide trials. Costs that exceed .0125 percent of the county's property tax revenues are eligible for reimbursement from the State Controller. Costs under this provision do not include costs incurred by the trial courts. The Governor's Budget proposes an appropriation of $2.5 million from the General Fund for this purpose in 2007-08. This amount represents a reduction of $1 million from the $3.5 million provided in the current year. The Department of Finance indicates that only $600,000 in claims has come in so far this year. However, costs for this program can be highly variable since they depend on the number of especially costly homicide trails that occur in small and rural counties.

Technical Correction. The dates in Provision 3 of this item should refer to 2008 rather than 2007. No other issues have been raised concerning this item.

ITEM 9100 TAX RELIEF

At its March 13th hearing, the Subcommittee held open this item pending discussions concerning the Open Space Subvention Program (Williamson Act). Those discussions have concluded and no issues have been raised.

ITEM 9612 ENHANCED TOBACCO SETTLEMENT ASSET-BACKED BONDS

In accordance with Government Code Section 63049.1, the Enhanced Tobacco Settlement Asset-Backed Bonds item appropriates $1,000 (General Fund) and authorizes the Director of Finance to augment this amount by up to $200 million if tobacco settlement revenues are insufficient to pay the costs of debt service and operating expenses. In 2003, the state sold $2.3 billion of Tobacco Settlement Bonds that included enhanced security. The state provided this enhanced security by entering into a binding covenant with bondholders that the Governor will request an annual budget appropriation from the General Fund to pay debt service on the bonds to the extent that Tobacco Settlement revenues fall short. This item in the annual budget carries out that obligation. However, it is not anticipated that the General Fund will be required to make any payments.

ITEM 9625 INTEREST PAYMENTS TO THE FEDERAL GOVERNMENT

Under federal law, the state must pay interest to the federal government on federal funds held by the state in advance of their expenditure. The federal assistance programs affected are those programs that have $216 million or more in federal fund expenditures. For the majority of these programs, state agencies request federal funds in advance of the warrant (i.e., check) issuance. State agencies use this funding technique because the State Constitution requires that the funds be deposited before the warrants are issued. Interest payments to the federal government are due no later than March 31 each year. The March 31, 2007 payment will be for the interest liability incurred during the state's 2005-06 fiscal year.

The Governor's Budget includes $30 million from the General Fund and $900,000 from the State Highway Account in the State Transportation Fund to make estimated interest payments in 2007-08.

ITEM 9840/9850 AUGMENTATION FOR CONTINGENCIES AND EMERGENCIES

Prior to 2004-05, the administration was authorized to "spend at a rate that would result in a deficiency" by the authority provided under the former Budget Act language and Government Code Section 11006. Beginning with the 2004 Budget Act, the administration no longer has this authority. Instead, a new process governing augmentations for contingencies and emergencies is in place to address departments' unanticipated expenses. The primary intent in making this change was to provide the Legislature the opportunity to exercise its control over appropriations by being notified of any unanticipated expenses *prior* to them being incurred. This framework is intended to rely on "pay as you go" budgeting.

How Unanticipated Expenses Are Funded. Under this process, the administration is required to notify the Legislature of any departmental requests to fund unanticipated expenses. Approved unanticipated expenses are funded with either a transfer of funds from Item 9840 or a supplemental appropriation sought through legislation.

- **Transfer of Funds.** The administration's use of the funds appropriated in Item 9840 ($49 million General Fund, $15 million each for special funds and nongovernmental cost funds, and $2.5 million of loan authority) is governed by the provisions of the item. These provisions prohibit the use of these funds in certain circumstances, including (1) any prior-year expenditure, (2) startup costs not yet authorized by the Legislature, (3) costs that the administration had knowledge of in time to include in the May Revision, and (4) costs that the administration has the discretion to incur or not to incur.

- **Supplemental Appropriations Bills.** The administration also may request enactment of supplemental appropriations bills to augment the amount in this item for specific needs, or if funding needs exceed the amount appropriated in this item. Requests for supplemental appropriation measures must be made to the Chair of the Joint Legislative Budget Committee and the fiscal chairs in each house, and they must provide similar information and comply with the same restrictions as to purpose as a transfer from the item.

For the current year, the Governor's Budget estimates that $70.5 million ($45.7 million General Fund) will be spent from this item, and an additional $703 million (General fund) will be provided in supplemental appropriations bills. The Department of Finance indicates that this amount now has increased by $28.1 million. The largest amounts of supplemental appropriations have been for the Department of Mental Health (past liabilities for Early and Periodic Screening, Detection, and Treatment—EPSDT—services) and for the Department of Corrections. The budget does not include any set-aside for supplemental appropriations in 2007-08 although they generally total hundreds of millions of dollars annually.

No issues have been raised concerning the proposed 2007-08 appropriations.

ITEMS TO BE HEARD

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT (HCD)

The mission of the Department of Housing and Community Development (HCD) is to expand housing opportunities for all Californians. The department administers housing finance, economic development, and rehabilitation programs with emphasis on meeting the shelter needs of low-income persons and families, and other special needs groups. It also administers and implements building codes, manages mobile home registration and titling, and enforces construction standards for mobile homes.

The Governor proposes $968.6 million ($15.6 million General Fund) and 597.2 positions for the department – an increase of $314.3 million (48 percent) and 70.3 positions.

The majority of the Department's expenditures are supported by general obligation bond revenue. The budget includes $58 million from the Emergency Shelter Trust Fund Act of 2002 (Prop 46) – down by $170.8 million from 2006-07 due to the full expenditure of bond funds for some programs. The budget includes $659.4 million from the Housing and Emergency Shelter Trust Fund Act of 2006 (Prop 1C). Portions of Prop 1C funds are continuously appropriated, and the department is using this existing authority to expend $161 million in Prop 1C funds in 2006-07. The second largest revenue source is federal funds, estimated at $174.5 million in 2007-08, which is about the same as 2006-07. Remaining expenditures of about $77 million are covered by the General Fund ($15.6 million), fees, and other miscellaneous revenues.

ISSUE 1: PROPOSITION 1C: HOUSING AND EMERGENCY SHELTER TRUST FUND ACT OF 2006

The issue for the subcommittee to consider is BCP #3, which authorizes $6.4 million (various funds) in 2007-08, of which $3.8 million require legislative authorization, and 45.0 new positions to perform the workload associated with the implementation of Proposition 1C. The request includes out-year budget adjustments for annual changes in workload. The 2008-09 budget request is for $10.5 million and 71.0 positions.

BACKGROUND:

Proposition 1C provides for a general obligation bond issuance not to exceed $2.85 billion. The Governor proposes to expend $653.0 million of Prop 1C revenues in 2007-08 (excluding $6.4 million and 45 new positions for administration). Using existing expenditure authority, the department plans to spend $160 million in 2006-07 (excluding $1 million for administrative costs), for a combined two year total of $820 million. Some Prop 1C programs are already continuously appropriated and other programs require a Budget Act appropriation to authorize expenditure. The administration has submitted statutory language, which is currently being discussed in policy committees, to implement certain Prop 1C programs. The chart below outlines proposed Prop 1C expenditures by category and indicates whether each program will be administered by the Housing and Community Development (HCD) Department, or by the California Housing Finance Authority. Dollars are in thousands and 2006-07 and 2007-08 allocations exclude administrative costs.

PROPOSITION 1C Category	2006-07 Allocations	2007-08 Allocations	Total Proposition 1C	Appropriation	Budget
Home Ownership Programs					
CalHome	$35,000	$55,000	$290,000	Continuous	HCD
CA Homeownership Program (BEGIN)	0	40,000	125,000	Budget Act	HCD
Self-Help Housing Program	0	3,000	10,000	Continuous	HCD
CA Homebuyers Down-payment Assistance Program	0	15,000	100,000	Continuous	CalHFA
Residential Development Loan Program	0	15,000	100,000	Continuous	CalHFA
Affordable Housing Innovation Fund	0	15,000	100,000	Budget Act	HCD
Multi-Family Rental Housing Program					
General	70,000	140,000	345,000	Continuous	HCD
Supportive Housing	20,000	80,000	195,000	Continuous	HCD
Homeless Youths	15,000	15,000	50,000	Continuous	HCD
Other Programs					
Joe Serna Jr. Farmworker Housing Loans/Grants	20,000	40,000	135,000	Continuous	HCD
Emergency Housing Assistance	0	10,000	50,000	Continuous	HCD
Infill Incentive Grants	0	100,000	850,000	Budget Act	HCD
Transit Oriented Development	0	95,000	300,000	Budget Act	HCD
Housing Urban-Suburban and Rural Parks	0	30,000	200,000	Budget Act	HCD
TOTAL	**$160,000**	**$653,000**	**$2,850,000**		

COMMENTS:

Subcommittee members will hear a presentation from HCD staff, Department of Finance (DOF) and Legislative Analyst Office (LAO on Proposition 1C funding, programs, and recommendations.

There are several bills moving through policy committees in both the Senate and the Assembly that would have an impact on the timing, appropriation levels and staffing needs of the programs being funded from this bond. Budget staff recommends that this issue remains open and that it be considered at a later subcommittee hearing.

Item 2260, the California Housing Finance Agency (CalFHA) was noted in the daily file as one of the items to be heard in subcommittee. However, funds for these programs are continuously appropriated and do not appear in the annual budget bill. Therefore, this item will not be heard.

Budget staff would like to note that although the majority of CalHFA's programs are funded through revenue bonds that do not depend upon the faith, credit, or taxing power of the State of California, two propositions, Proposition 46 in 2002, and Proposition 1C in 2006, provide general obligation bond funds to support CalFHA's Downpayment Assistance Program and the Residential Development Loan Program. The Governor's Budget indicates CalHFA will expend $30 million of $200 million available from Proposition 1C in 2007-08. Of the $30 million, $15 million would support the Down-Payment Assistance Program and $15 million would support the Residential Development Loan Program. Recent discussions with CalHFA suggest 2007-08 Proposition 1C expenditures may be closer to $45 million.

ISSUE 2: BASELINE ADJUSTMENT – CONSENT ITEM

Baseline Adjustment: Re-establishment of 18 out of 57 positions that were eliminated by Control Section 31.60 of the *Budget Act of 2002* and Control Section 4.10 of the *Budget Act of 2003.* Since the elimination of these positions did not result in a reduction of HCD's budget, no new funding is being requested.

ISSUE 3: IT SUPPORT FOR CASAS – CONSENT ITEM

IT Support for the Codes and Standards Automated System (CASAS). HCD is requesting 3.0 new permanent positions for system maintenance and support activities for CASAS. The program supports the automated business processes of the Division of Codes and Standards. The new positions will replace staff currently provided through a maintenance contract that expires in 2006-07. Due to the funding shift from contract staff to state staff, no additional funding is required to support these positions. The shift, however, will result in a $144,000 in savings from special funds that can be redirected for CASAS development projects.

ISSUE 4: CALIFORNIA ENTERPRISE ZONE PROGRAM – CONSENT ITEM

California Enterprise Zone Program: HCD is requesting a fund shift of $747,000 in 2007-08 and $695,000 in 2008-09 (General Fund) and 4.0 new positions to increase technical assistance and program support to the Enterprise Zones, Targeted Tax Area, Manufacturing Enhancement Areas and Local Military Base Recovery Areas. Changes in federal regulations allow the department to access additional federal funds of $697,000 in the Community Development Block Grant (CDBG) and then shift the same amount of General Fund support to the Enterprise Program resulting in no net cost to the General Fund. In addition, the requested amount includes $50,000 from reimbursement revenues received from the $10 application fee, which was established by SB 763 Lowenthal (Chapter 634, Statutes of 2006).

ISSUE 5: FACTORY BUILT HOUSING PROGRAM – CONSENT ITEM

Factory-Built Housing (FBH) Program. HCD is requesting $287,000 in 2007-08 and $263,000 in 2008-09 in Special Funds and 3.0 new positions to provide oversight of third-party inspections and certification of an increased number of factory-built in housing from about 16,000 building components and eight dwellings in 2002-03 to over 89,000 building components and almost 300 dwellings in 2005-06. The three positions include two Codes and Standards District Representatives II and one Staff Services Analyst to provide monitoring and complaint resolution, analysis and related data and statistical activities.

ISSUE 6: COMMUNITY DEVELOPMENT BLOCK GRANT– CONSENT ITEM

Community Development Block Grant (CDBG): HCD is requesting $444,000 (Federal Trust Fund) in 2007-08 and ongoing and 4.0 new positions to meet federal mandate requirements for monitoring and fiscal management of the program.

ISSUE 7: INFORMATIONAL TECHNOLOGY TECHNICAL SUPPORT UNIT– CONSENT ITEM

Information Technology Technical Support Unit: HCD is requesting $174,000 (various funds) in 2007-08 and $162,000 in 2008-09 and 1.0 new permanent System Software Specialist 1 position to address IT workload increases. This request includes $50,000 in funding for a contract with California State University, Sacramento for the purpose of hiring part-time student assistants. Increases in workload have resulted from the introduction of new technologies such as remote access, BlackBerries, Web-based application access and expanded PC support.

ISSUE 8: CONTACTS OFFICE – CONSENT ITEM

Contracts Office: HCD is requesting $116,000 (various funds) in 2007-08 and $101,000 in 2008-09 and 1.0 Staff Services Manager I position. Currently, the Contracts Office has four staff but lack a first line supervisor, which typically performs final contract review and approval, technical support, staff training and other duties. In addition, workload increases in the office due to new funding and the number and complexity of the contracts have resulted in a backlog of contracts waiting for review and approval. The working supervisor will expedite the processing of the contracts as well as provide monitoring of these same contracts.

ITEM 8885 COMMISSION ON STATE MANDATES

The task of the Commission on State Mandates is to fairly and impartially determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The commission was created as a quasi-judicial body to determine state mandated costs and consists of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, a public member with experience in public finance, and two additional members from the categories of city council member, county supervisor, or school district governing board member, appointed by the Governor and approved by the Senate. The budget proposes General Fund support of $1.7 million in fiscal year 2007-08 and 13.6 personnel-years (PYs) of staff for support of the commission. These amounts are the same as in the current year.

No General Fund Provided for 2007-08 Local Government Mandate Claims. The bulk of the commission's budget is for local assistance to reimburse local governments for their costs of carrying out state-mandated local programs. The budget proposes a total of $11.5 million for these payments in 2007-08, all from special funds (primarily the Motor Vehicle Account in the State Transportation Fund). This is a relatively minimal amount compared with a total of $404.1 million for mandate reimbursement payments in the current year, of which the bulk--$402.4 million—was from the General Fund. The Governor's budget provides no General Fund money to pay local government mandated cost claims that will be filed in 2007-08. The Legislative Analyst's Office (LAO) estimates that General Fund local government mandate claims for 2007-08 will total around $150 million, excluding any AB 3632 costs above the categorical funding (see below).

The budget continues to suspend 28 mandates that are suspended in the current year (most of which have been suspended for some time).

AB 3632 Mental Health Services for Students. The Governor's budget for the Department of Mental Health includes $52 million (General Fund) as categorical funding to counties (rather than mandate reimbursement) for this program in 2007-08, plus $69 million in additional federal special education funding budgeted in the Department of Education. The 2006-07 Budget also provided $52 million for categorical funding in 2006-07 plus an additional $66 million to pay mandate claims for 2004-05 and 2005-06, prior to the provision of any categorical funding. However, any excess county costs may be claimed under the mandate reimbursement process.

K-14 Education 2007-08 Mandate Costs Also Essentially Unfunded. Funding to pay K-14 education mandate costs is not included in the commission's budget, but is appropriated to the Department of Education as part of Proposition 98 funding. However, the budget essentially follows the same funding policy for K-14 mandate costs. It defers payment of all but $4 million of approximately $185 million of annual General Fund Proposition 98 mandate costs. Because K-14 mandate payments are included within the Proposition 98 requirement, they generally do not have any additional effect on the state budget. Instead, mandate reimbursements to schools and community colleges act to reallocate Proposition 98 funding from other education programs or among the individual school districts and community college districts.

ISSUE 1: DEFERRED PAYMENT OF 2007-08 GENERAL FUND MANDATE CLAIMS

As noted above, the Governor's budget provides no General Fund money to pay local government mandated cost claims that will be filed in 2007-08 for 38 local government mandates that are subject to Proposition 1A and not suspended. Instead, the budget proposes to pay these claims in 2008-09. The administration points out that its proposal would not violate the requirements of Proposition 1A.

Proposition 1A Pay-or-Suspend Rule for Local Governments. Proposition 1A, adopted by the voters in November 2004, generally requires that the state either fund mandate reimbursement claims that have been filed and approved as of the time that the budget is considered or suspend any mandate that is left unfunded. That is, the budget must appropriate money to pay claims filed in the previous year, and which the state already has in hand before it may continue to require local governments to incur costs for those mandates in the following year. There are a number of exceptions. The "pay or suspend" rule does not apply to claims for costs incurred prior to fiscal year 2004-05 (these "deferred" payments are being paid over a 15-year period starting in the current fiscal year), nor does it apply to mandated costs for school districts or community colleges, or mandates relating to local government employee relations and benefits. However, the state still has a constitutional requirement to pay these claims.

It should be noted, however, that Proposition 1A does not, and was not intended to, prohibit payment of mandate claims on a current basis. The pay-or-suspend rule focuses on claims already filed because this is a known quantity at the time that the budget is passed, while claims for the budget year can only be estimated.

Budget Proposal Departs from Recent Policy. After several years of deferring most mandate payments due to the state's fiscal problems, the 2005-06 Budget appropriated a total of $241 million for mandate payments to local governments. This amount included funding for both the 2004-05 mandate cost claims (which were required to be paid in the 2005-06 budget to comply with Proposition 1A and avoid suspension of those mandates) *and* for payment of 2005-06 cost claims. Although Proposition 1A's "pay-or-suspend" rule did not require the payment of 2005-06 claims until 2006-07, the Legislature and the administration made a policy choice to provide more timely payments to local governments, consistent with existing law, and to more fully recognize the costs of mandated programs in the state budget.

The 2006-07 Budget continued this policy. It provided $90.3 million to pay remaining 2005-06 claims for unsuspended mandates as required by Proposition 1A, and it also provided $109 million to pay the estimated costs of these mandates in 2006-07. Furthermore, the 2006-07 Budget also included $32 million to pay 2005-06 and 2006-07 claims for the Peace Officers' Procedural Bill of Rights (POBOR) mandate, an employee-relations mandate not subject to Proposition 1A.

LAO Recommends Either Funding 2007-08 Claims or Changes to Existing Law

The 2007-08 Governor's budget proposes a revised policy in which the state would only pay claims for General Fund mandates subject to Proposition 1A and POBOR in the subsequent year. This would not violate Proposition 1A's pay-or-suspend rule. However, it would not be consistent with the claiming process laid out in current law.

Under existing Government Code provisions, local governments (and schools) may file estimated mandate reimbursement claims for the current year with the State Controller's Office (SCO) by January 15th each year. These claims also include revisions to adjust prior-year estimates to actual costs. Alternatively, local governments and schools may choose to file only claims for actual costs, rather than estimates. Statutorily, these claims are intended to be paid promptly and they begin to accrue interest after 60 days. Under the budget proposal, the state would incur interest costs on the deferred claims and local governments would have to "float" these costs until they receive payment.

Audit Deadline Would Also Be Extended. The SCO generally may initiate an audit up to three years after payment is made to a claimant for a specific mandate and a specific fiscal year. Audits must be completed within two years. Consequently, claims are open to audit adjustment for up to five years after a payment is made. By deferring payment for a year, the budget proposal would have the effect of extending the audit deadline, in addition to the payment date, by a year.

COMMENTS

LAO Recommendation. The LAO recommends that the Department of Finance either propose funding for 2007-08 mandate claims (about $150 million for local governments and $185 million for K-14 Education) or propose statutory changes to the Government Code to be consistent with a delayed payment schedule.

Deferral May Make Fiscal Oversight Less Timely and Less Likely. One approach to revising the current statutory framework would be to eliminate the filing of estimated claims and, instead, require all claims to be filed on an actual basis by January 15 of the subsequent year. This would have the advantage of greater accuracy, but the Legislature would have less timely information on cost trends. The other problem with deferral, as the LAO points out, is that it provides less incentive for the Legislature to take actions to control mandate costs, since those actions would not have result in any immediate budget savings.

ISSUE 2: POTENTIAL FUNDING NEEDED FOR PAST MANDATE COSTS

Newly-Identified Mandates

The commission has provided the Legislature with statewide cost estimates for the following four newly-determined mandates:

1. False Reports of Police Misconduct ($126,000)

2. Crime Victim's Domestic Violence Incident Reports ($919,000)

3. Peace Officer Personnel Records: Unfounded Complaints and Discovery ($1.8 million)

4. Integrated Waste Management for Community Colleges ($10.8 million, Proposition 98).

No Funding in Budget. The budget does not include any funding for these newly-identified mandates. The first three are subject to Proposition 1A, so they must be funded or suspended. The Integrated Waste Management Mandate for Community Colleges (which is under the jurisdiction of Subcommittee 2) is not subject to Proposition 1A. Furthermore, the commission's finding for that mandate currently is being challenged in a lawsuit by the Department of Finance and the Integrated Waste Management Board. The department and the board point out that the mandated activities produce large amounts of offsetting revenues and savings that the colleges have retained, but which the commission did not consider in its finding or estimate.

Potential Shortfall in AB 3632 Funding

The LAO estimates that counties will file mandate claims totaling $40 million for AB 3632 costs in excess of the categorical and special education funding provided in the current year. These costs would have to be funded in the 2007-08 Budget in order to comply with Proposition 1A. In addition, LAO estimates that county excess AB 3632 costs for services provided in 2007-08 will total $90 million.

Some Current-Year Savings May Be Available

The Department of Finance indicates that some of the mandate funding provided in the current year may remain unspent and available to cover a portion of the costs identified above. The SCO is finalizing its tally of mandate claims and so the actual amount should be known soon.

COMMENTS

The Department of Finance should inform the Subcommittee regarding the following:

1. Whether it proposes to fund, defer, repeal, or take other actions concerning the newly-identified mandates.

2. The magnitude of the potential AB 3632 funding shortfall and how the administration proposes to deal with it.

3. The potential amount of current-year savings that could be used to offset the costs above.

ISSUE 3: MANDATE PROCESS REFORM

A Dysfunctional Process

The current mandate process takes too long and is overly legalistic. “Test claims” filed by local governments (alleging the existence of a mandate) typically take over five years to be resolved by the Commission on State Mandates. During this time, state fiscal liabilities mount and local governments carry out mandates without reimbursement. The claiming guidelines that result from this lengthy process attempt to be precise, but that precision often results in complex rules. This is because few mandates constitute distinct programs; rather they usually add some additional task or requirement to an existing activity. Furthermore, the cost of the additional task or requirement may be reimbursable only in certain circumstances. For example, the LAO points out that whether or not the cost of recording and transcribing certain proceedings is reimbursable under the POBOR mandate depends on who turned on their tape recorder first. Local governments and schools devote considerable resources to mandate record keeping, but the SCO disallows about one-third of local government mandate claims because they are inadequately documented or otherwise do not comply with the commission’s complex guidelines. Local governments often appeal these claim reductions to the commission, causing further delays in the mandate payments and diverting commission staff from their primary tasks.

The following indicators illustrate some of the problems in the existing process:

- The commission currently has 14 Parameters and Guidelines (Ps&Gs--claiming rules) determinations pending. The *most recent* legislation establishing any of these mandates was enacted in 2003 and some of the mandate legislation dates back to the 1980s.

- Initial statewide cost estimates currently pending at the commission relate to claims initially filed in 2002 or earlier.

- 118 Incorrect Reduction Claims (challenging reductions by the SCO) are pending at the commission.

- Ongoing litigation occurs around many mandate issues.

Seeking a Simpler Approach—"Reasonable Reimbursement Methodology." In an effort to simplify the mandate claiming process and reduce the number of mandate audits, the Legislature enacted Chapter 890, Statutes of 2004 (AB 2856, Laird), with every member of the Assembly Special Committee on State Mandates serving as a coauthor. (The special committee met for over a year and reviewed the mandate process in depth.) Chapter 890 authorized the commission to adopt a “reasonable reimbursement methodology” for mandates, a methodology that places greater emphasis on the use of unit costs and other approximations of local costs, rather than detailed documentation of actual local costs. Unfortunately, although DOF and local agencies have proposed reasonable reimbursement methodologies, the commission has not yet adopted one. A significant obstacle to use of this approach has been the commission’s legal interpretation that it must ensure that *actual* local government cost data from *all* potential claimants—a requirement that generally is impossible to meet because some local governments and school districts may not incur costs under a mandate until many years later.

Administration Proposes an Alternative Process

The administration has proposed Budget Trailer Bill Language to create an alternative to the cumbersome, contentious and lengthy current process in which the commission determines mandates and establishes their reimbursement guidelines. In the alternative process, the Department of Finance will work with local agencies to develop a cost-efficient method of compliance with new laws and a reasonable and relatively simple way to determine the amounts to be reimbursed to local governments. This new "joint determination" process would encourage local agencies and the Department of Finance to determine together, within 12 months of the enactment of a new statute, whether a new mandate has been imposed and the cost guidelines for that mandate. Costs, once agreed upon by both parties, would be submitted for Legislative review in the budget bill. If local agencies disagreed with the joint determination, they could opt to follow the current mandate determination process.

LAO Supportive, But Some Improvements Needed

LAO agrees with the administration's general approach, but identifies the following problem areas in the proposal:

- **Diminishes the Legislature's Information and Policy Options Regarding Mandates.** Under current law, the Legislature receives a legal decision and proposed methodology regarding each mandate and may direct the commission to reconsider these documents if it believes the commission did not consider important information. The Legislature also may modify the reimbursement methodology and/or reduce funding for a mandate, as long as its actions do not interfere with local government's constitutional right to reimbursement. Under the administration's proposal, in contrast, the Legislature's role is reduced to reviewing the agreement negotiated between the administration and local governments—and accepting or rejecting it.

- **Does Not Acknowledge the Legal Alternatives Available to Local Governments That Disagree With a Proposed Settlement.** The administration's proposal appears to assume that a mandate settlement, negotiated between DOF and *some* local governments, would be the *sole* basis for mandate reimbursement for *all* local governments. Given that the California Constitution entitles local governments to reimbursement of their mandated costs, LAO thinks it likely that the courts would allow local governments that are not satisfied with the funding provided under this negotiated settlement to file court actions for additional reimbursement.

- **Expedites and Simplifies Too Few Mandates.** The administration indicates that it wishes to focus its efforts on those claims that are subject to the annual mandate payment requirement of Proposition 1A. This measure provided exceptions for mandates affecting educational agencies and pertaining to employee rights. Such an approach greatly reduces the potential effectiveness of the Administration's proposal. LAO notes that 55 of the 86 mandate test claims pending before the commission are from educational agencies and five others relate to employee rights, both exempt from Proposition 1A's annual pay-or-suspend requirement. Thus, less than a third of these 86 test claims potentially could be expedited under the administration's proposal.

LAO Proposes a More Extensive Alternative Process

Building on the Governor's proposal, LAO has developed its own reform package to expedite and simplify the mandate determination process without altering local rights or state responsibilities under the Constitution's mandate reimbursement requirement. The LAO proposal appears in the office's publication: *The 2007-08 Budget Perspectives and Issues*. LAO maintains that the variation in local government mandates means that no single change would improve the process for all claims. Accordingly, the LAO reform package includes the following three elements that LAO recommends that the Legislature enact as *optional* alternatives to the existing process:

- **Amend the existing Reasonable Reimbursement Methodology Statute.** Our proposal clarifies the type of easy-to-administer reimbursement methodology that the Legislature envisioned when it enacted this statute. While we would encourage the commission to use this approach to the greatest extent possible, the commission could adopt Ps&Gs using the existing approach (documented actual costs) if it were most appropriate for a specific mandate.

- **Modify the Existing Mandate Process to Allow Reimbursement Methodologies and Estimates of Statewide Costs to Be Developed Through State-local Negotiations, With Minimal Commission Oversight.** This option would replace the existing adversarial process with a single negotiated step, expediting the existing process by at least a year. Because the negotiated Ps&Gs would be based on the reasonable reimbursement methodology approach described above, this negotiated process also simplifies the claiming process.

- **Create an Alternative Mandate Process That Bypasses the Commission Process Entirely.** This alternative would resolve mandate claims in about a year, thus offering the greatest potential for expediting the mandate process. While this alternative probably would be used for only a small number of claims (where there is a wide agreement between local governments and the administration), any reduction in the number of claims would improve the commission's processing time for other claims.

- **Provide Stability While Recognizing Local Government Rights.** Local governments and schools have a constitutional right to adequate reimbursement of mandated costs. Accordingly, the state cannot arbitrarily impose conditions or limitations on payment. Neither can some local government entities bind all others to the same agreement. However, the state cannot be in the position of allowing local governments to choose their reimbursement methodology each year—claiming some standard average amount when their costs are low or nonexistent and seeking full-cost reimbursement when their costs temporarily exceed the standard. In order to avoid these problems, the LAO proposal includes the following features:

  - A requirement that the administration and local government negotiators (1) use information from a wide range of local governments to develop their proposed reimbursement methodologies and (2) assess and verify local support for any methodology before it is proposed to the Legislature. In addition, the Legislature could reject a proposal and request that it be renegotiated to secure a higher level of local acceptance.

- A prohibition on local governments that object to a proposed settlement from receiving the negotiated reimbursements. Instead, these local governments must file a test claim with the commission and proceed through the regular mandate determination process.

- A requirement that local governments that accept negotiated funding must remain under this reimbursement system and not file a test claim related to the mandate for five years. (This restriction would not apply, however, if the Legislature changed the reimbursement methodology or the funding amount so as to reduce the funding to which the local government was entitled.)

- A provision that if a court or the commission later finds that the state's reimbursement amounts were not sufficient, any state funding provided to local agencies pursuant to the alternative dispute resolution process counts as an offset to the state's overall liability.

Commission Staff Recommendation

At the direction of the commission, the Commission on State Mandates staff has analyzed both the administration and LAO mandate reform proposals. The staff has recommended a number of revisions to the LAO proposal to take account of some procedures now available in existing law and to provide a more developed legal and operational foundation for "legislatively determined mandates" in order to ensure coordination with the commission processes.

COMMENTS

The administration, LAO, and the commission should present their proposals to the Subcommittee and note significant areas of agreement and difference.

Related Legislation. AB 1576 (Silva) incorporates the LAO proposal. AB 1222 (Laird) makes a technical change to test claim requirements, but also could serve as a vehicle for mandate reform. AB 1170 (Krekorian) would automatically approve mandate test claims if the commission did not act on them within 24 months.

ITEM 9210 LOCAL GOVERNMENT FINANCING

The Local Government Financing budget items provide certain types of general financing and law enforcement grants to local governments. However, they represent only a small portion of state funding for local governments. Most of that funding is provided within various programs, particularly in Health and Social Services, and in direct funding for law enforcement through allocation of Local Public Safety Fund sales tax revenues and transportation subventions. Local governments also receive a permanent ongoing larger portion of property tax revenues to offset the reduction in the Vehicle License Fee (which the state funds by replacing the loss of property tax to schools).

Proposed spending in 2007-08 is $294.3 million (all General Fund)—essentially the same as in the current year. The large reduction of $1 billion in the current year, compared with 2005-06 is due to $1.2 billion of one-time funding provided 2005-06 to make local governments whole for the Vehicle License Fee "Gap Loan."

Local Government Financing
Spending by Program
(thousands)

Program	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Percentage Change
Aid to Local Government	$1,205,330	$53,500	$55,509	3.8%
Citizens' Option for Public Safety/ Juvenile Justice Grants	125,825	237,725	238,000	0.1%
Special Supplemental Subventions	2,115	2,709	800	-70.5%
Total Expenditures (All Programs)	**$1,333,270**	**$293,934**	**$294,309**	0.1%

Programs Funded in the Budget

The Governor's Budget includes funding for the following ongoing programs:

- **Juvenile Justice Crime Prevention Act.** The Governor's budget proposes $119 million for local juvenile justice grants—the same amount as in the current year.

- **Citizens' Option for Public Safety (COPS).** The Governor's budget also proposes to maintain COPS funding at $119 million—the same as in the current year. The program provides per-capita grants for local police departments, sheriffs, and district attorneys.

- **Rural and Small County Law Enforcement Grants.** The Governor's budget fully funds this program at $18.5 million, which provides grants of $500,000 to 37 counties.

In addition, the Governor's Budget includes funding for the two programs discussed in the following issues.

ISSUE 1: LOCAL DETENTION FACILITIES SUBVENTIONS

Budget trailer legislation in 2006 authorized a new system of jail access fees that are much more limited than booking fees. In return, counties will receive subventions for jail operations, maintenance or construction. The Governor's budget includes $35 million to fund these new subventions in 2007-08. The subventions will be allocated to each county and to cities that operate jails in proportion to each entity's booking fee revenue in 2006-07). Starting in 2007-08, local governments may no longer charge general booking fees. Instead counties and cities that operate Type One jails may charge a "jail access fee" up to the full cost of processing a booking, but the new fee would be assessed only on the number of non-felony bookings for any local entity that exceed that entity's most recent three-year average of bookings. Arrests for driving under the influence offences, domestic violence and violation of protective orders would be excluded from this calculation. If the state provides less than $35 million in jail subventions in any year, then counties and cities could reinstate general booking fees.

COMMENTS

Technical Correction Needed. The Governor's Budget intends to fund the new jail facility subventions. However, the language in Provision 1 of Item 9210-105-0001 cites Government Code Section 29550, which provides for Booking Fee Subventions. The Department of Finance indicates that this is an error. The citation in the language should be corrected to Section 29552.

ISSUE 2: REINSTATEMENT OF LIMIT ON REDEVELOPMENT SUBVENTIONS

The administration proposes to reduce subventions to redevelopment agencies by $1.9 million, compared with the current-year estimate in the budget. These redevelopment subventions were instituted after the state eliminated personal property tax supplemental subventions to redevelopment agencies in the late 1980s. The current subventions were intended to ensure that redevelopment agencies would not default on bonds that had been backed with personal property tax subvention revenue. Until 2003-04, the budget contained an in-lieu appropriation with language limiting the subventions to the amount actually needed to cover debt service on bonds that were backed by the supplemental subventions when they were issued (now a very small amount) and only if normal tax increment revenues to the redevelopment agency were inadequate. However, the in-lieu appropriation was vetoed in 2003-04. This had the unintended consequence of eliminating the restriction to actual debt-service needs. As a result, the amount of subventions increased from under $1 million to $2.7 million, providing a small windfall to several redevelopment agencies. The Governor's Budget now proposes to reinstate the in-lieu appropriation and the previous limitation language, reducing the cost to an estimated $800,000.

COMMENTS

Provision 3 of the language proposed in the Governor's Budget requires the State Controller to prorate the subventions if they are inadequate to meet debt-service needs. Although the $800,000 provided in the appropriation should be adequate, it would be preferable to delete the proration language and instead ensure that the full amount needed to pay debt service (beyond the amount of revenues otherwise available to agencies) will be available by adding the following Budget Bill language (as Provision 3):

> Notwithstanding any other provision of law, the Director of Finance may authorize an expenditure in excess of the amount appropriated in this item, to the extent necessary to fund all allocations required pursuant to Provision 2, not sooner than 30 days after notification in writing of the necessity therefor is provided to the chairpersons of the fiscal committees of each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may in each instance determine.

ITEM 9620 PAYMENT OF INTEREST ON GENERAL FUND LOANS

The Governor's Budget in January included Budget Bill appropriations of $20 million for interest on internal cash-flow borrowing (short-term borrowing within the state treasury from special funds) and $358,000 for interest costs on prior budgetary loans from special funds to the General Fund. Interest is paid at the same time that the budgetary loans are repaid.

ISSUE 1: MAXIMIZING CASH-FLOW EARNINGS

The Governor's Budget estimates that the General Fund will spend an additional $39 million in the current year and $87 million in 2007-08 for interest on *external* cash-flow borrowing—revenue anticipation notes (RANs) that the state sells to investors (these amounts are continuously appropriated). Generally, the state experiences cash shortfalls early in the fiscal year, when disbursements tend to outpace receipts. The situation generally reverses towards the end of the fiscal year, when a large amount of tax payments come in. Consequently, the General Fund usually borrows funds to cover short-term cash needs in anticipation of revenues. The budget assumes that the state will sell a $3.5 billion RAN in November and repay it in May 2008.

Cash-Flow Operations Are a Profit Center

The budget also estimates that the General Fund will receive $571 million in interest earnings on General Fund cash balances deposited the Pooled Money Investment Fund in 2007-08. Accordingly, General Fund cash-flow operations are projected to earn a net of about $464 million in 2007-08 ($571 million earnings less $20 million for internal borrowing costs and $87 million for external borrowing costs).

Earnings Not Maximized in the Budget

According to the Department of Finance (DOF), the $3.5 billion RAN size is based on minimizing the amount of the state's external borrowing. The RAN is limited to the amount needed to cover any projected cash shortfall and to provide a reasonable cushion to account for uncertainty. This is a policy that fails to maximize the state's net interest earnings.

The state is able to borrow money at low short-term tax-exempt rates. Meanwhile, the state may invest the proceeds of any spare balances at the Pooled Money rate, which is a generally higher taxable rate, resulting in a net gain. The amount that the state may borrow on a tax-exempt basis is limited by federal arbitrage rules, but, according to the Department of Finance the budget does not propose to borrow the full amount that would be allowed under federal tax law.

It should be noted that short-term cash-flow borrowing has no effect on the state's budgetary position—other than the *net* interest cost or earnings that are achieved.

COMMENTS

1) Staff has requested the Legislative Analyst's Office (LAO) to provide the subcommittee with an estimate of how much additional net revenue the General Fund could earn on its cash-flow operations in 2007-08.

2) If the LAO identifies a significant potential for additional revenue, then the Subcommittee may wish to recognize the additional revenue and adopt placeholder language to implement an earnings-maximizing cash-flow policy in consultation with DOF, LAO, the State Treasurer's Office and the State Controller's Office.

3) The state's cash-flow operations should be handled as an enterprise function. In addition to ensuring that the state has adequate cash to operate throughout the year, it should maximize net interest earnings or minimize net interest expense, depending on the overall condition of the General Fund.