SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair
Senator Tom Berryhill
Senator Norma Torres

Wednesday, May 21, 2014
9:00 a.m.
Room 2040

Consultant: Farra Bracht

AGENDA - PART A

STATE FINANCE AND ADMINISTRATION

PROPOSED VOTE-ONLY

PROPOSED DISCUSSION/VOTE

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling 916-651-1505. Requests should be made one week in advance whenever possible.

ITEMS PROPOSED FOR VOTE-ONLY

Statewide Item

Item 1: Elimination of Control Section 9.45 (Governor's Budget Proposal)

Proposal. The Administration proposes to eliminate Control Section 9.45.

Background. According to the Administration, Control Section 9.45 was removed from the Governor's proposed budget because it is rarely, if ever, used by departments. Under Control Section 9.45, a reporting requirement to the Department of Finance and the Legislature existed if all of the following criteria were met:

- Prop 40, Prop 50, or Prop 84 funds were to be used directly or through a grant for the acquisition, restoration, or rehabilitation of a project.
- The funds being used were for a grant or project not appropriated in statute.
- Total expenditure (not limited to Props 40, 50, and 84) exceeds $25 million.

Other considerations that factored into the decision to remove the language included the public review processes required in Public Resources Code 5096.513 and Government Code 15853 (Property Acquisition Law). Both statutes require information to be made public prior to a public hearing for acquisitions. Additionally, it is unlikely that funding would be provided for a grant or project where the total expenditure is in excess of $25 million, but has not been appropriated in statute.

The Control Section language previously included in the budget act is as follows:

(a) Any state agency, department, board, or commission shall provide notification to the Department of Finance and the Joint Legislative Budget Committee not less than 30 days prior to committing funding from Proposition 40 (California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002), Proposition 50 (Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002), or Proposition 84 (Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006), if all of the following criteria apply:

(1) The funds will be used, either directly or through a grant, for the purchase of interests in or the restoration or rehabilitation of property.

(2) The funds will be used for a grant or project that is not appropriated in statute by name or description.

(3) The total expenditure for the project, including, but not limited to, Proposition 40, 50, or 84 funds is in excess of $25,000,000.

(b) The notification shall include a detailed description of the portion of the project being funded and a detailed description of the whole project. For the purposes of this section, the criteria set forth in subdivision (a) shall apply to both single transactions and cumulative transactions that involve the purchase of properties near or adjacent to each other. (c) For purchases and grants meeting the criteria set forth in subdivision (a), the state agency, department, board, or commission may take public actions and hold public meetings prior to 30 days following notification only if such actions are expressly approved pending the completion of the 30-day review by the Department of Finance and the Joint Legislative Budget Committee, or not sooner than whatever lesser time the Chairperson of the Joint Legislative Budget Committee, or his or her designee, may in each instance determine. The seller or grantee shall be explicitly notified in writing of this condition 10 days prior to any action taken.

Staff Comment. Staff is concerned that the re-appropriation of unexpended bond funds could result in potentially significant amounts of bond funds being available for expenditure, and if this language were removed, the Administration would not have to report to the Legislature on the expenditure of these funds which could exceed $25 million. Removing this language would reduce legislative oversight. The removal of Control Section 9.45 could be revisited next year after assessing how much in bond funding from Props 40, 50, and 84 might be available for re-appropriation.

Staff Recommendation. Reject the elimination of Control Section 9.45.

Vote.

Item 2: Amendment to Control Section 12.00 (Governor's May Revision)

Proposal. The Administration requests that the budget bill be amended to reflect the updated change in the State Appropriations Limit (SAL), as required by the State Constitution. The revised limit of $89.902 billion is the result of applying the growth factor of 0.48 percent. The revised 2014-15 limit is $564 million below the $90.466 billion estimated in January.

Staff Comment. Staff has no concerns with this technical change.

Staff Recommendation. Approve the revision to the State Appropriations Limit.

Vote.

9600 Debt Service, General Obligation Bonds, and Commercial Paper

Item 1: Reduction in General Obligation Bond Debt Service Costs (Governor's May Revise Proposal)

Proposal. The Administration proposes a reduction in budget year debt service requirements of $82 million General Fund from the Governor's budget to a total of $5.8 billion. The decrease is due to reduced General Obligation debt service costs ($5.2 billion) and no change in lease-revenue bond debt service costs ($610 million). The decrease is primarily due to a 1) smaller spring bond sale, 2) lower interest rates and fees, and 3) savings related to bond refinancings this spring.

In addition, current year debt service will decrease by $113 million, for a total of $5.4 billion. This amount includes $4.8 billion General Obligation debt service costs and $576 million lease-revenue bond debt service costs. The General Obligation debt service savings stem from a 1) projected increased premium generated from spring 2014 bond sales, 2) savings related to bond refinancings, and 3) reduced interest rates and fees.

Staff Comment. Staff has no concerns with this proposal.

Staff Recommendation. Approve the May Revision budget request.

Vote.

ITEMS PROPOSED FOR DISCUSSION AND VOTE

Statewide Items

Item 1: Trailer Bill Language Relating to Departments' Cash Needs (Governor's January Budget)

Background and Detail. The Financial Information System for California (FI$Cal) Project is a partnership of four control agencies: the Department of Finance, the State Controller's Office, the State Treasurer's Office, and the Department of General Services. FI$Cal is expected to provide the state with a single integrated financial management system that encompasses budgeting, accounting, procurement, cash management, and financial management and reporting. This "Next Generation" project, through the adoption of best business practices, is expected to reengineer business processes; improve efficiency; enhance decision making and resource management; and provide reliable, accessible, and timely statewide financial information allowing the state to be more transparent.

Currently, departments can spend from accounts that are funded by reimbursements prior to the department collecting those reimbursements. Once FI$Cal is implemented, departments will need to have funds in an account that is to be funded by reimbursements prior to spending from that account.

To address this limitation created by the implementation of FI$Cal, the Administration proposes trailer bill language that would allow the Department of Finance to authorize a short-term cash loan from the General Fund or from other funds administered or used by the requesting department. This type of loan is considered a cash flow loan for temporary cash shortages and shall not constitute a budgetary loan, revenue, or expenditure. The language also directs departments to make every reasonable effort to promptly collect reimbursements or amounts payable from other funds, or collect the amounts in advance, so as to minimize the use of these types of loans.

In 2014-15, the following departments are in the first wave of the implementation of FI$Cal:

- Agricultural Labor Relations Board
- California Arts Council
  - California State Summer School for the Arts
- Department of Aging
  - California Commission on Aging
- Department of Alcoholic Beverage Control
  - Alcoholic Beverage Control Appeals Board
- Department of Fair Employment and Housing
- Department of Finance
- Department of Justice
- Office of Environmental Health Hazard Assessment
- San Francisco Bay Conservation and Development Commission

- State Board of Equalization
- State Controller's Office
- State Treasurer's Office
    - Contracted Organizations

Staff Comment. It is unclear why a statutory change is needed and if this language potentially gives the Administration authority beyond that needed to work around limitations of FI$Cal. The language does not limit state departments' borrowing to address cash shortages to situations created by the implementation of FI$Cal. Instead, the language broadly applies to any state department that is unable to collect reimbursements as needed, and, as a result, encounters a temporary cash shortage.

According to the Administration, the same purpose could be accomplished with a Control Section in the Budget Act, similar to provisional language which is adopted each year for some departments to allow for short-term cash borrowing within the fiscal year. For the first wave of departments affected by the implementation of FI$Cal, budget control language could be adopted and then the adequacy of that language to address the problems anticipated by the Administration assessed by the Department of Finance (DOF) and reported on to the Legislature during next year's budget subcommittee hearings. The DOF has indicated that it anticipates continuing the practice of proposing budget bill language for short-term loans, but that that may change in the future.

Questions.

1) Under this proposed language, what happens when reimbursements do not come in as anticipated? Does this become a General Fund obligation?

2) What happens when a short-term cash loan from the General Fund is not repaid within the fiscal-year?

3) Why doesn't the language limit this authority to cash flow needs created by departments using FI$Cal?

Staff Recommendation. Reject the proposed trailer bill language and direct staff to work with the Department of Finance to develop budget control language to address the problem related to short-term cash needs created by the implementation of FI$Cal.

Vote.

Item 2: Trailer Bill Language Relating to the State Public Works Board and Reserve Funds (Governor's May Revise Proposal)

Proposal. The Administration proposes amendments to delete the statutory requirement that excess construction reserve bond proceeds be used to pay debt service.

Background and Detail. The State Public Works Board (Board) is authorized to issue lease-revenue bonds to finance authorized capital outlay project costs, as well as other associated costs, including a reasonable construction reserve, capitalized interest, and other issuance costs. The Board has historically used Pooled Money Investment Account (PMIA) loans to fund short-term project costs through the majority of the construction phase, with long-term bonds issued at that time to repay the PMIA loan and fund the balance of project costs, if any. When issuing bonds toward the end of construction, there are generally fewer unforeseen cost issues, thus not requiring a large reserve. Because of the small amount of funds that have traditionally remained upon project completion, the statutory requirement that funds remaining in the construction reserve be used to pay debt service has not been a significant issue until recently.

The Pooled Money Investment Board (PMIB) revised its lending policy for the PMIA in the fall of 2008 in response to General Fund cash flow concerns and to help the state meet its obligations. Initially, all new loans from the PMIA were halted. The PMIB eventually approved a $500 million limit for critical, court-ordered projects. As a result, the Board has issued bonds for many projects ineligible for PMIA loans prior to the start of construction, which increases the need for a larger construction reserve to ensure sufficient funds are available should unforeseen conditions be encountered, such as high construction bids, large change orders, or weather delays.

Projects that were financed as described above are now complete or close to being complete, with excess funds in the construction reserve that are currently only available to offset debt service. While the payment of debt service with excess construction reserve funds is allowed under federal law, the extent may vary based on the facts of a particular bond issue. The proposed trailer bill language would provide additional flexibility for the Board to use these proceeds to fund other legislatively-authorized project costs. Using the excess reserve funds in this manner would not only be more fiscally efficient, by eliminating duplicate issuance costs, it would allow greater flexibility for compliance with complex federal, post-issuance compliance laws. Therefore, this proposal allows for more cost-effective project financing and increased flexibility for compliance with federal tax law.

Staff Comment. This proposed change would provide the Administration with greater flexibility to manage excess bond funds and thereby reduce borrowing costs. According to the Administration, the State Treasurer's Office is supportive of this proposal. In addition, the DOF has committed to providing a report to legislative staff on the use of these funds by July 1, 2015.

Questions.

1) How do the proposed changes to state law enable the Administration to finance state infrastructure projects more cost-effectively?

Staff Recommendation. Approve the proposed amendments to Government Code sections 13332.11 and 13332.19 to delete the statutory requirement that after completion of the project, excess construction reserve funds must be used to pay debt service.

Vote.

9600 Debt Service, General Obligation Bonds, and Commercial Paper

Item 1: Commercial Paper Program Technical Amendments (Governor's May Revise Proposal)

Proposal. The Administration proposes trailer bill language be added to cap qualified expenses on the state's commercial paper (CP) program and clarify eligible expenditures.

Background and Detail. State law permits the issuance of CP Notes for the General Obligation (GO) bond program. The STO issues CP Notes which enable the state to fund departments cash needs for projects and provide "just-in-time funding". This approach has many benefits because it 1) allows the state to achieve lower overall financing costs by limiting the amount of undisbursed bond funds from long-term debt obligations, 2) provides the state flexibility, and 3) CP Notes can be issued more quickly than long-term bonds. In order to issue CP Notes, the STO incurs a variety of expenses.

The State Attorney General's Office, as the issuer's counsel for the state's GO bond program, recently advised the STO to seek an amendment to the Government Code which provides an unlimited appropriation for the payment of expenses on GO Bond CP Notes.

The purpose of the proposed amendment is to specify the amount of the appropriation for costs incurred for CP Notes and to comply with the requirement that an appropriation from the General Fund must include both a specific amount (or formula for determining the maximum amount) and a designated purpose.

The proposed cap for expenses associated with issuing CP Notes would be three percent of the maximum principal amount of the CP Notes that could be purchased and outstanding at any one time and a cap of 0.25 percent for other costs not tied to a specific agreement.

Staff Comment. Staff has no concerns with this proposal.

Staff Recommendation. Adopt proposed placeholder trailer bill language.

Vote.

9620 Cash Management and Budgetary Loans

Item 1: Reduction in Borrowing Costs (Governor's May Revise Proposal)

Proposal. The Administration proposes a reduction in the budget for the payment of debt service on cash flow borrowing. The proposal would reduce the amount necessary for interest costs on internal cash flow borrowing by $30.0 million, from $60.0 million to $30.0 million, and for interest costs on external borrowing by $30.0 million, from $60.0 million to $30.0 million. These reductions are made possible by the expectation of continued low prevailing interest rates in the financial markets and a reduced need for cash flow borrowing. A minor increase also is proposed for interest on budgetary loan repayments from $54.0 million in January to $54.4 million for the May Revision.

Staff Comment. Staff has no concerns with this proposal.

Questions.

LAO

1) Please provide your assessment of the proposed borrowing costs and any recommendations regarding these costs.

Staff Recommendation.

Vote.