

# Repaying Special Fund Loans

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LEGISLATIVE ANALYST'S OFFICE

Presented to:  
Senate Budget and Fiscal Review Committee  
Hon. Mark Leno, Chair





## Background

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- ☑ ***Special Fund Loans Helped General Fund.*** Over the past decade, the state lent balances of its special funds to the General Fund in order to help address budget shortfalls. As of June, \$4.6 billion of special fund loans were outstanding.
- ☑ ***Governor Proposes to Repay Almost All These Loans by 2016-17.*** The administration plans to repay about \$700 million of the outstanding special fund loans in 2013-14. The administration's multiyear budget plan foresees repaying all of these loans by the end of 2016-17, except for the \$500 million borrowed from the Greenhouse Gas Reduction Fund.
- ☑ ***To Date, Legislature Has Granted Administration Discretion.*** Courts have generally deferred to the Legislature to determine when special funds need to be repaid. (Case law provides general guidance that loans need to be repaid so as not to "interfere with the object for which the special fund was created.") The Legislature has typically deferred to the administration concerning the timing and level of special fund loan repayments.



## Today's Topic: Seven of the Loans to Be Repaid in 2013-14

- Examining Repayments to Two Department's Funds.** The administration's multiyear budget plan foresees repaying about \$700 million in special fund loans in 2013-14. Of these, six special fund repayments concern accounts of the Department of Consumer Affairs (DCA), and one repayment concerns a special fund of the Department of Business Oversight.
  
- Operating Deficits Exist in These Funds.** As shown in the figure below, a characteristic common to these seven funds is that all are projected by the administration to have an operating deficit, in which their annual revenues are insufficient to fully fund annual expenditures.

2013-14 Loan Repayments for Departments of Consumer Affairs and Business Oversight						
<i>(Dollars in Millions)</i>						
Special Fund	Annual Revenue	Annual Expenditures	Operating Deficit	Loan Amount to be Repaid in 2013-14	Fund Balance <sup>a</sup>	Months in Reserve <sup>a</sup>
Credit Union Fund	\$7.3	\$7.5	-\$0.3	\$1.4	\$2.7	4
Speech-Language Pathology and Audiology and Hearing Aid Dispensers Fund	1.8	1.9	-0.1	0.3	0.3	1
Real Estate Appraisers Regulation Fund	2.5	5.4	-2.9	8.1	7.0	15
State Dentistry Fund	8.0	11.9	-3.8	2.7	1.6	1
Bureau of Home Furnishings and Thermal Insulation Fund	3.9	4.9	-1.0	1.5	2.0	4
Professional Engineer and Land Surveyor Fund	9.5	9.9	-0.5	2.5	2.3	2
Behavioral Science Examiners Fund	7.6	8.1	-0.5	1.4	2.2	3

<sup>a</sup> Reflects administration's estimate of fund balance at end of 2013-14 including the loan repayment.



## Establishing Legislative Priorities on Special Fund Repayments

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- ☑ **Examining the Special Funds.** The plan to repay many special funds in the coming years creates an important opportunity for the Legislature to explore the financial operations of special funds and develop a more detailed understanding of the services they support. (At the end of this handout, we provide an Appendix that lists key questions budget committees may want to ask the administration concerning special funds receiving loan repayments.)
  
- ☑ **Setting Legislative Priorities.** By learning more about the special funds, the Legislature will be in a position to set priorities with respect to special fund loan repayments. The Legislature may wish to consider:
  - Which special funds should be repaid sooner rather than later?
  - Which special fund programs or fees require changes?
  - How do special fund loan repayments rank among various General Fund budget priorities?
  
- ☑ **Administration Cooperation Essential.** The Department of Finance (DOF) and special fund departments generally have better access than the Legislature to timely and accurate information concerning the current condition and cash flow situation of special funds. If the Legislature wishes to examine a special fund in detail, it would be best if DOF and departments are asked well in advance to address key questions, such as those in this handout's Appendix.



## Issues for Legislative Consideration

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- Do Expenditures Consistently Exceed Revenues?*** A special fund with an operating deficit may need its loans repaid before a special fund with a balanced budget or an operating surplus. Regardless of the circumstances that led a given special fund to previously develop a large reserve, various operational costs do generally increase over time. In some cases the Legislature may decide that fee increases are necessary to maintain a desired level of service over the next few years.
- Are Special Fund Programs Cost-Effective?*** The cost-effectiveness of a special fund's activities should also be evaluated when considering loan repayments or a change in the fund's fee structure. This is a good opportunity for the Legislature to consider if it wants to change the priorities of some special fund programs—such as by reducing certain spending commitments.
- What Is an Appropriate Fund Balance?*** Generally, special fund reserves should be sufficient to cover routine seasonal cash flow fluctuations or periodic annual declines in revenue. An appropriate level can be expected to vary from one fund to another, but, as a general rule, a reserve of several months should be sufficient. Some planned loan repayments—to the Real Estate Appraisers Regulation Fund, for example—could result in a large reserve in the near term.
- Is a Substantial, One-Time Cost Anticipated?*** Larger reserves may be justified if a relatively large one-time or short-term expense is expected. The DCA, for example, is currently implementing a new information technology solution that will result in temporarily higher costs to these boards and bureaus.



## Issues for Legislative Consideration

*(Continued)*

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- Are Reductions in Fees Justified?*** The Legislature can consider whether special funds with structural surpluses, large loan balances, or large reserves (relative to expenditures) are adequately serving the needs of their fee payers and the public. In some cases, the Legislature may consider temporary or permanent special fund fee reductions. In other cases, additional program activities or staffing may be desired.



## Appendix: Key Questions for the Administration

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- What is the current fund balance of the special fund and what is the current outstanding loan balance?
- How many months of operating costs are needed in reserve to cover routine seasonal cash flow fluctuations or periodic annual declines in revenue?
- Does the special fund currently have an operating deficit or surplus?
- Are operating revenues increasing or decreasing? Why and at what rate?
- Are operating expenses increasing or decreasing? Why and at what rate?
- How much will scheduled pay increases and projected increases in California Public Employees' Retirement System costs affect the special fund over the next few years?
- Are any large, one-time costs or revenues anticipated?
- What are the current and historical staff vacancy rates in the department, board, or bureau whose activities are supported by the special fund?
- Does the department, board, or bureau have performance targets?
- How does the department, board, or bureau set fee levels? How frequently are the fees evaluated to ensure they are at an appropriate level and what criteria are used to determine this?
- What interest rate is the General Fund paying to borrow money from this special fund?