SUBCOMMITTEE NO. 4

STATE ADMINISTRATION and GENERAL GOVERNMENT

State Administration and General Government

Information Technology

BACKGROUND:

The role of Information Technology for state operations has taken many transformations in the past several decades. The state's IT governance has largely been filled by a few attempts to react to situations overshadowed by a procurement scandal that left a large void where a central technology planning agency should have been present. For years many were left wondering why the state home to Silicon Valley was incapable of harnessing technology assets to develop a more cost efficient and effective government.

The passage of AB 2408 (Smyth), Chapter 404, Statutes of 2010, codified a cabinet-level agency to serve as the central IT organization to provide approval and oversight of all state information technology projects. More specifically, AB 2408 codified the Governor's 2009 Reorganization Plan that integrated the Department of Technology Services, the Telecommunications Division within the Department of General Services, and the information security functions previously provided by the Office of Information Security and Privacy Protection into the Technology Agency. AB 2408 also transferred duties related to IT procurement from the Department of Finance, Department of General Services, and the Department of Information Technology to the California Technology Agency. In addition to consolidating statewide IT functions under one cabinet-level agency, the legislation passed in 2010 was also responsible for coordinating activities of agency and department CIO's, and promoting the efficient and effective use of information technology in state operations.

According to an August 2011 report issued by the California State Auditor, the California Technology Agency currently oversees over 70 different IT projects totaling roughly $7.8 billion dollars over the lifetime of the projects. Under most circumstances, the information technology approval process begins with the host agency or department submitting a feasibility study report that is filtered through the Office of the Chief Information Officer and from there sent to the Department of Finance for the development of a budget proposal before the Legislature. Usually, the formal procurement process does not begin until funds have been allocated by the Legislature.

GOVERNOR'S PROPOSAL:

The Governor proposes $504.7 ($4.1 million GF) and 1,266.5 positions for the department. This budget reflects a $29 million dollar increase ($500,000 GF) over the 2011-12 budget. The 2012-13 budget request's $34.1 million in funding for an increase in data center workload and to replace various hardware and software components that are utilized by the agency. Additionally, the agency is requesting $2.5 million and six positions to offer continued technical support to the Employment Development Department and their identity management system.

ISSUES TO CONSIDER:

Further Consolidation of IT components in the state

In addition to reorganizing the state's IT governance structure; AB 2408 set forth four performance targets for the Technology Agency. Below is a table identifying the specific performance targets and the progress made by the Technology Agency (July 2011).

Area	Performance Target	Status (July 2011)
Reduce Energy Usage	20% by July 2011 30% by July 2012	37% reduction in energy usage From 170,000 MWh to 107,028 MWh
Network Consolidation	Begin migration to CGEN by July 2011	99.5% of network circuits in migration
Email Consolidation	Be in migration to shared e-mail solution by June 2011	99% of e-mail boxes in migration
Reduce Data Center Square Footage	50% by July 2011 (182,000 sq. ft)	44.7% reduced

According to the Little Hoover Commission, the agency has achieved an estimated $700 million dollars in savings by avoiding duplicative projects. While it is difficult to attribute the total sum of cost avoidance due to rejecting duplicative IT projects to the agency, it is safe to assume that the cross agency coordination undertaken by the Technology Agency has helped the state to realize better IT procurement practices in the short term. Additionally, consolidation of data centers and warehouses has led to cumulative cost savings of an estimated $75 million dollars. The Technology Agency is on the cusp of achieving the performance targets set forth by the Legislature. It may be wise for the Legislature to identify additional cost saving objectives for the agency to achieve in the near future.

IT Procurement Strategy

Large scale systems integration projects only comprise a small fraction of the overall number of contracts, yet the cost of these larger IT projects consume an outsized proportion of the state's IT budget annually. A 2009 report conducted by the LAO found that the state's use of a single, prescriptive, procurement process might not be the best fit for some IT projects, such as the larger, more complex projects that consume an outsized proportion of the state's annual IT procurement budget. The integration of larger, more complex IT systems might be able to avoid some cost overruns if the state were able to utilize a multi-stage procurement process that integrated multiple layers of review throughout the process. Unlike the more traditional contract award process that the state regularly uses; the multi-stage procurement process initially could have multiple vendors awarded contracts. These vendors would then be charged with building a small scale version of their product for review by the customer, who, in turn, would decide which vendor would be awarded with the full contract. Through increased dialogue and interaction it is likely that the state would achieve some cost reductions, yet, it is worth noting that the procurement timeline would likely need to be extended due to the nature of the contract. To achieve greater cost reductions in the IT procurement life cycle it might be wise for the Legislature to consider mechanisms, such as the LAO's proposal, that would enhance dialogue between the vendor and the customer/state entity.

Revenues

BACKGROUND:

The Governor and the LAO have both forecast modest growth in the economy. The Governor has projected that there will be very rapid growth in certain segments of the economy--particularly income for high-income taxpayers. Furthermore, the Governor assumes federal law will not change and the lower federal tax rates on regular and capital gains income will sunset at the end of 2012 causing some taxpayers to shift gains from 2013 to 2012. However, despite these few bright spots, the Governor's forecast reflects the lingering effects of the Great Recession with revenues that remain tens of billions below the amounts projected in 2007-08.

The State's General Fund revenues are generated primarily from the following three major tax sources:

- **Personal Income Tax (PIT)**. Over the past decade, the PIT has generated over 50 percent of the total GF revenues and is estimated to generate about $52 billion in the current fiscal year (not including the Governor's proposed tax changes). This is about the same level as was received in 2010-11 primarily because of a reduction to the PIT rate of 0.25 percent on every bracket that started in the 2011 tax year. The PIT is expected to account for over 60 percent of GF revenues in the budget year mainly due to the reduction in the State sales tax and the realignment of a portion of the State sales tax to the locals to fund the 2011 Public Safety Realignment. Taxes attributable to wages and salaries make up the vast majority of the GF revenues, but capital gains also can contribute a significant amount to PIT revenues. Also in the past decade, capital gains tax paid has ranged from $2.6 billion to nearly $12 billion.

  The PIT's proportion of GF revenues has grown steadily over the past decade and is proposed to make up 62 percent of the General Fund revenues in the budget year. This is mainly due to the policy decision to dedicate a portion of the sales tax to local governments to fund the 2011 Public Safety Realignment.

- **Sales and Use Tax (SU).** The SUT has generated about 30 percent of GF revenues over the past decade and is expected to generate around $19 billion in the current fiscal year. This is less than in prior years due to the expiration of the 1 percent temporary sales tax on July 1, 2011, that resulted in annual revenue loss of $5 billion. This is also due to the realignment of 1.0625 percent of the State sales tax to local governments to fund the 2011 Public Safety Realignment.

- **Corporation Tax (CT).** The CT has remained between 8 percent and 12 percent of state GF revenues over the past decade and is estimated to generate about $9.5 billion in the current year. This is less than the revenues collected from the corporate tax in the prior year and the Governor's revenue forecast for the budget year is for further declines in the corporate taxes paid. This is counter to rising corporate profits due to several corporate tax cuts implemented over the last several years. The corporate tax cuts that will result in fewer corporate tax revenues over the next several years include: (1) the change to an elective single sales factor apportionment that started in 2011; (2) the ability of unitary taxpayers to share tax credits among members of the unitary group that started in 2010; (3) the ability to carry back net operating losses to prior years, which will start in 2012; and (4) the end of the temporary suspension of net operating losses which was operative from 2008 through 2011. The LAO estimates that the revenue loss from these recent tax law changes will be over $1 billion in 2012-13.

GOVERNOR'S PROPOSAL:

Governor Proposes Temporary Taxes. The Governor is currently circulating a Constitutional Amendment that would raise the following revenues temporarily for five years starting in 2012:

- **Temporary Personal Income Tax Rates on Highest Income Californians**. The Governor's initiative would add three additional tax brackets. For single filers with income between $250,000 and $300,000 and joint filers with income between $500,000 and $600,000 an additional 1 percent would be applied to income above $250,000 and $500,000, respectively. Income between $300,000 and $500,000 for single filers and income between $600,000 and $1,000,000 for joint filers would be assessed an additional 1.5 percent. Finally, income over $500,000 for single filers and income over $1,000,000 for joint filers would be assessed an additional 2 percent. These changes are expected to raise $5.8 billion in revenues in the current and budget years combined.
- **Temporary Sales Tax Rate Increase of 0.5 percent**. The Governor's initiative would also temporarily raise the sales tax rate by 0.5 percent. This portion of the initiative is expected to generate $1.2 billion in additional revenues in the budget year.

Tax Enforcement. The Governor has proposed to build upon the successful implementation of the Financial Information Records Match (FIRM) program by the Franchise Tax Board (FTB). This program enables the FTB to compare financial records with debts owed the State to ensure collection. The Governor has proposed to expand FIRM to the Employment Development Department (EDD) and the Board of Equalization (BOE) beginning in 2013. This will enable EDD to collect unpaid wage withholding debts and the BOE to collect unpaid sales and use tax debts. These programs are expected to generate $15 million in the current and budget years.

Furthermore, last year, there was significant discussion about how to improve enforcement of use tax collection by firms that do not maintain an instate footprint (mainly Internet retailers). Ultimately, the implementation of the comprehensive enforcement effort enacted in June 2011 (Chapter 7x, Statutes of 2011 [AB 28x, Budget]) was delayed until later in 2012 by Chapter 313, Statutes of 2011 (AB 155, Calderon). The Governor's budget assumes that the tax enforcement changes included in the original bill will ultimately be implemented later in 2012 and will generate $50 million in additional revenues in the budget year.

Other Tax Policy Changes. The Governor has not proposed any other significant tax policy changes as part of the overall budget solution. However, the Governor's budget indicates that he will continue to pursue changing current law to make the multi-state corporate income apportionment method mandatory instead of elective and reforming the tax incentives that benefit enterprise zones. However, the Governor has indicated that he will pursue these policy changes separate from the budget, as part of a larger job creation effort proposed through policy legislation.

ISSUES TO CONSIDER:

Large Forecast Differences Due to Volatility of Capital Gains and Top Earners. The LAO's initial review of the Governor's Department of Finance's (DOF's) revenue projections are that they are approximately $3.9 billion higher over the three year period starting in 2010-11. Furthermore, because of differences in their expectations of revenues generated by the highest income earners, the LAO also has projected that the Governor's proposed Constitutional Amendment may generate about $2 billion less in revenues than projected by the Governor. These two factors account for a $6 billion spread between what the DOF has forecast and the LAO.

However, the vast majority of the differences are attributed to assumptions made around capital gains tax and the tax paid by the highest income earners. As noted in the background, tax revenues attributed to capital gains have been extremely volatile and have varied greatly over the past decade. Furthermore, the state has become more and more dependent on the tax revenues paid by the top one percent of taxpayers. In 1980, the top one percent of taxpayers had about 10.5 percent of total income. For 2010 the same top one percent of taxpayers now has over 22 percent of total state income. These two factors have made projecting income tax revenues extremely difficult and subject to error.

Corporate Tax Low and Could Get Worse (or Better). The LAO described in their November 2011 Fiscal Forecast the difficulty in projecting Corporate Tax (CT) accurately. First, there are significant lags in getting certain data related to CT, which hinders the ability to determine how recent policy changes have affected revenues. Second, the numerous policy changes outlined in the background section have made forecasting CT even more difficult. Historically, forecasters have used ratios between California taxable profits and national profits to determine trends. However, given the significant changes in tax policy and the volatility of the economy, these trends may be less useful in predicting revenues. Bottom-line, the CT forecast is subject to some uncertainty and despite corporate profit gains—there are significant downside risks from recent changes to corporate tax policy.

Tax Forecasts are Adjusted for Actual Tax Collections and Refunds. Tax payments and refunds are examined monthly to assess the accuracy of the revenue forecast. The January Governor's Budget revenue forecast is the starting point then the LAO releases an updated revenue forecast in February; and the Governor again releases a revenue forecast with the May Revision. Each subsequent forecast benefits from additional months of actual tax collection and refunds. Both the Controller and DOF release updates on tax collection in the first half of each month. Taxes are remitted in different ways – employment wages and bonuses are part of employer withholdings, which the employer remits to the state. Estimated quarterly payments are required for taxpayers that have capital gains or other significant income outside of wage earning. Sales taxes are remitted in monthly payments by retailers. Corporations make quarterly tax payments. Tax refunds are also tracked in monthly data for taxpayers who overpaid their tax. The following are some of the key tax dates that occur during the period of budget deliberations:

- **January 15**: Final quarterly estimated payments for personal income tax are due for the 2011 tax year.
- **January 31**: Final sales tax payments are due from retailers for the fourth quarter of 2011.
- **March 15:** Tax filing deadline for corporate taxpayers.
- **April 15:** Tax filing deadline for the personal income tax for the 2011 tax year, and due date for the first quarterly estimated payment for the 2012 tax year. For corporations that use calendar years for reporting, the first quarterly payment is due.
- **April 30:** Final sales tax payments are due from retailers for the first quarter of 2012.

Housing

BACKGROUND:

The state offers a variety of programs designed to support homeownership interests, increase the state's housing stock, and provide individuals with special needs a home. The majority of these programs are administered by the Department of Housing and Community Development and the California Home Financing Agency.

The mission of the Department of Housing and Community Development (HCD) is to help promote and expand housing opportunities for all Californians. As part of this mission, the department is responsible for administering a variety of housing finance, economic development, and rehabilitation programs. Some of the programs administered by the department, such as California Homebuyer's Downpayment Assistance, provide financial assistance so that low- and moderate-income families can purchase a home. While other programs, like Multifamily and Supportive Housing, provide assistance for the construction, rehabilitation, and preservation of permanent and transitional rental housing for low-income and disabled individuals and households. The department is also responsible for implementing and enforcing building standards.

In 2002 voters approved Proposition 46, which authorized a total of $2.1 billion in state bonds for a variety of new housing investments. Annual grant and loan awards increased and this was sustained in 2006 after the passage of Proposition 1C. The new bond measure authorized an additional $2.85 billion, most of which was again used to support affordable housing efforts. Nearly all of the funding from Proposition 46 has been allocated and there are only a limited amount of Proposition 1C funds remaining in the proposed 2012-13 budget year allocations.

The second largest revenue source is federal funding, estimated to be $189.9 million in 2012-13, which would be roughly the same as 2011-12. Remaining expenditures are comprised of fees, General Fund ($7.3 million), and other miscellaneous revenues.

Much of the federal funding is provided by the U.S. Department of Housing and Urban Development to support local Public Housing Authorities (PHA's). Public Housing Authorities are local agencies that are responsible for the administration of low-income federal assistance housing programs. There are currently over 100 Public Housing Authorities in the state. The Department of Housing and Community Development administers assistance to 12 rural counties that lack a local Public Housing Authority.

According to the most recent census data there are 466,244 households in California that rely on federal rental assistance programs to afford modest housing. The majority of the assistance provided by the Department of Housing and Urban Development is directed towards Housing Choice Vouchers. The Public Housing Authority calculates the maximum amount of housing assistance allowable. The maximum housing assistance is generally the lesser of the payment standard minus 30 percent of the family's monthly adjusted income or the gross rent for the unit minus 30 percent of monthly adjusted income. The PHA pays the landlord the remainder of the rent over the tenant's portion, subject to a cap referred to as "Fair Market Rent" (FMR) which is determined by HUD. Each year, the federal government looks at the rents being charged for privately owned apartments in different communities, and the costs of utilities (heat, electricity, etc) in those communities. The "Fair Market Rents" are an estimate of the average gross rents (rents plus utilities) for medium-quality apartments of different sizes in a particular community. As an example, 2012 FMR for 1 bedroom housing in Los Angeles-Long beach is $1159.

Additionally, the U.S. Department of Housing and Urban Development is responsible for the distribution of Community Block Development Grant funds. The Community Block Development Grant program provides block grants to local entities in order to fund redevelopment, economic development and the preservation/restoration of historic properties in low income neighborhoods. The Department of Housing and Urban Development distributed approximately $350 million dollars to both entitlement and non-entitlement entities (California Department of Housing and Community Development is responsible for the administration of funds for non-entitlement entities) for federal fiscal year 2012.

GOVERNOR’S PROPOSAL:

The Governor proposes $275.3 million ($7.3 million GF) and 542.1 positions for the department – a decrease of $351.4 million. The precipitous decrease in funding is largely reflected in the agency expending nearly all of the proceeds of the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C).

The California Housing Finance Agency (CalHFA) receives its funding support from revenue bonds and is not subject to budget act appropriation. Originally chartered in 1975, the agency was created to serve as the state’s affordable housing bank in order to assist first time homebuyers by providing affordable mortgage loans. The agency produces an annual report and is subject to an audit conducted by an outside auditor each year. While not subject to budget act appropriation, their budget is presented for informational purposes. CalHFA will have $52.5 million dollars and 328.4 positions for the 2012-13 budget.

Proposition 1C Bonds (dollars in millions)

Program	Original Authority	Remaining	Approp Type	Total
Homeownership Programs Cal-Home	$290	-	Continuous	$290
Self-Help Housing	$10	-	Continuous	$10
Building Equity and Growth in Neighborhoods (BEGIN)*	$125	$26	Budget Act	$125
California Homeowners Down-payment Assistance Program (CHDAP) *	$100		Continuous	$100
Residential Development Loan Program (RDLP)	$100		Continuous	$100
Affordable Housing Innovation	$100		Continuous	$100
Subtotal	**$725**	$26		**$725**
Multifamily Rental Housing Programs Mutltifamily Housing Program (MHP) – General	$345	-	Continuous	$345
Supportive Housing	$195	-	Continuous	$195
Homeless Youth Housing	$50	$5	Continuous	$50
Subtotal	**$590**	**$5**		**$590**
Other Programs Serna Farmworker Housing Grant Program	$135	-	Continuous	$135
EHAP-CD	$50	-	Continuous	$50
Infill Infrastructure Grant	$850	$13	Budget Act	$850
Transit Oriented Development	$300	-	Continuous	$300
Housing Related Parks	$200	$161	Budget Act	$200
Subtotal	**$1,535**	**$174**		**$1,535**
TOTAL	**$2,850**	**$205**		**$2,850**

ISSUES TO CONSIDER:

Sources of Funding for Affordable Housing

Decreasing available bond proceeds coupled with the California Supreme Court's decision that resulted in the dissolution of redevelopment agencies has raised the question of where, or if, the state will be able to identify a funding source for affordable housing. Community Redevelopment Law had allowed a local government to establish a redevelopment area and capture all of the increase in property taxes that is produced within the area. The law was repealed with the dissolution of redevelopment. The Law required redevelopment agencies to deposit 20 percent of tax increment into a Low and Moderate Income Housing Fund to be used to increase, improve, and preserve the community's supply of low and moderate income housing available at an affordable housing cost. Statewide, Low and Moderate Income Housing Fund dollars have represented a significant source of funding for the construction, preservation, and rehabilitation of affordable housing.

The Legislature is currently considering legislation (SB 654) that would, among other things, allow a host city or county of a dissolving agency to retain the funds on deposit in the agency's Low and Moderate Income Housing fund. It is estimated that there is an amount in the range of $1 billion to $2 billion dollars in outstanding and unobligated balances in the Low and Moderate Income Housing funds maintained by redevelopment agencies throughout the state. Additionally, it would require the city or county to expend those funds in compliance with the housing provisions of the Community Redevelopment Law. Any funds that a city or county elected not to keep would be transferred to the Department of Housing and Community Development.

Excess Inventory Due to Foreclosures

Since 2008 the state's unemployment rate has nearly doubled. In addition to an increase in unemployment, the state has also seen a decrease in the rate of homeownership. In 2010 55.9 percent of households were homeowners, down by nearly 3 percent from the previous year. California remains one of the states with the highest foreclosure rates, yet there is often a mismatch between the current foreclosed housing stock, which is often larger and located in a suburban environment, and the demand for housing which is aligned with accessibility to jobs and a central location close to services.

Housing Voucher Assistance Limited

While housing starts continue to move forward at a record low pace, the need for affordable housing will persist. The foreclosure crisis has only exacerbated the need for rentals, as more individuals put off home buying due to the economic downturn. The Center for Budget and Policy Priorities reports that 1.4 million low-income renter households in California are paying more than half of their monthly cash income for housing costs. The federal vouchers do not come close to meeting the need for low-income housing in California. On average, these households have monthly incomes of $1,291 and pay housing costs of $1,143, leaving only $148 to pay for other necessities. Of the 1.4 million families paying more than half of their income towards housing costs, about 31 percent of these households are elderly or people with disabilities and 38 percent are families with children. Many of these jurisdictions have long waiting lists for a voucher. This leaves many households at risk of homelessness as reported in an LA Times article on January 18, 2012 the number of CalWorks families without a permanent place to live had increased nearly 100 percent in LA County.

Veterans

BACKGROUND:

There are approximately 2 million veterans living in the state, making California home to more veterans than any other state in the nation. The U.S. Department of Veterans Affairs regularly updates their statewide statistics; their most recent update (September 30, 2010) is below:

- Number of veterans – 1,971,959
- Total expenditures by the U.S. Department of Veterans Affairs in California - $9.1 billion
    - $3.8 billion in compensation and pension
    - $990 million in readjustment benefits
    - $3.9 billion in medical and construction programs
    - $170 million for insurance and indemnities
- Number of veterans receiving disability and compensation payments – 276,373
- Number of veterans using G.I. bill educational benefits – 46,897

The state performs three primary functions to support the needs of California's veterans and their families; guidance and representation through the disability and benefits claims process, direct loans for farms and homes, and long-term residential and medical care at one of the California Veterans Homes. The California Department of Veterans Affairs (CDVA), the agency charged with providing these benefits to the state's veterans, is designed to support the efforts of the United States Department of Veterans Affairs (USDVA) in providing healthcare and a wide array of other benefits to eligible veterans. The state and local government have long played an integral role in assisting the veteran access benefits provided by the USDVA, and, in some cases, provide additional benefits to returning service members. Recognizing that the state can provide an important service to veterans, the state has set aside funds to support the efforts of the USDVA and to also provide additional benefits, such as long-term residential care and the farm and home loan program.

The department operates veterans homes in Yountville, Barstow, Chula Vista, Ventura, Lancaster, and West Los Angeles. Homes in Redding and Fresno are under construction and were initially slated to open in 2012. These homes provide residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 62.

GOVERNOR'S PROPOSAL:

The Governor's budget proposes $362.3 million ($250.3 million GF) and 2,250.4 positions for the department. If implemented as proposed, General Fund support for the CDVA would increase from $217.1 million in 2011-12 to an anticipated $250.3 million in the budget year.

Summary of Expenditures (in thousands)

Fund Source	2011-12	2012-13
General Fund	$217,151	$250,331
Veterans Farm and Homebuilding Fund of 1943	$124,402	$103,938
Federal Trust Fund	$1,854	$4,305
Reimbursements	$1,497	$1,455
Other funds	$2,396	$2,274
Total	**$347,300**	**$362,303**

The Governor's budget includes a $27.8 million dollar increase to the General Fund due to adjusting staffing levels at the Redding, Fresno, and the Greater Los Angeles and Ventura County (GLAVC) Veterans homes. The Redding and Fresno Veterans Homes will be staffed only with personnel capable of maintaining a 'warm shutdown' while the GLAVC Veterans Home staff will be phased in at a slower pace than originally anticipated.

ISSUES TO CONSIDER:

Assisting veterans in obtaining federal benefits.
According to the statistics provided by the USDVA, 15.06 percent of the state's veterans are receiving disability or compensation benefits from the federal government, which lies slightly below the national average of 15.72 percent. Increasing the rate of participation rates for benefits has long been a goal of the Veterans Services division of CDVA. While the state does provide some funding for County Veteran Service Officers (CVSO's) to conduct outreach ($2.6 million dollars annually for all 54 counties) CDVA has limited influence on the outreach operations designed to connect the state's veteran population with federal benefits that they might be eligible to receive. Local agencies, such as CVSO's, or veteran specific non-profits have provided these services to veterans. A hurdle that the Veterans Services division often faces is that a CVSO's presence might vary by county, and are largely controlled by their respective county's board of supervisors. Therefore, the goals established by the CVSO's might not align perfectly with the goals of the Veterans Services division.

Unemployment

Each year, over 30,000 troops complete their military service and return to California. Between the often-difficult transition to civilian life and the struggling American economy, these new veterans are facing an uncertain economic future. Many Iraq and Afghanistan veterans leave the active-duty military only to find that their skills are not understood by civilian employers. Among Iraq and Afghanistan-era veterans of the active-duty military, the unemployment rate was over 20 percent in December of 2011, which is significantly higher than their civilian peers.

Looking at unemployment rates for veteran status shows that veterans have lower unemployment rates than nonveterans. However, the cumulative measurement masks the variations within the diverse group of veterans. Typically, young people have higher unemployment rates than do older people, and we see that reflected in the table below. However, young veterans are nearly twice as likely to be unemployed as their peers and the next peer group (ages 25-34) is only a slight improvement in employment rates for returning service members. The tables below identify the unemployment rate for veterans by age group and by conflict.

Unemployment Rates of Californians Age 20 and Over by Veterans Status

(November 2011; 12-Month Average of Current Population Survey of Households Data)

	All Persons	Non-Veterans Only	Veterans Only
All Ages, 20+	**11.0%**	**11.0%**	**10.8%**
Age 20-24	17.7%	17.5%	34.0%
Age 25-34	11.6%	11.4%	18.7%
Age 35-44	9.5%	9.5%	11.2%
Age 45-54	10.0%	10.1%	8.7%
Age 55-64	9.3%	9.3%	9.3%
Age 65+	9.5%	10.1%	7.2%

	Labor Force	Employed	Unemployed	Unemployment Rate
All Veterans	869,048	800,258	93,790	10.5%
OIF/OEF	116,224	90,872	25,352	21.8%
Gulf War I	157,915	142,401	15,514	9.8%
Vietnam Era (1964-1975)	294,492	272,357	22,135	7.5%

Source: Current Population Survey, U.S. Bureau of Labor Statistics

Compiled by: California Employment Development Department

Local Mandates

BACKGROUND:

Budget funding for non-education mandate payments to local governments is included in the budget of the Commission on State Mandates (Commission). The Commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution. Payments for mandate costs incurred prior to 2004 are one exception noted in the Constitution and pre-2004 mandate costs can be repaid over time. Another exception in the Constitution is for mandates related to labor relations – the State can defer payment of these mandates and still retain the mandate requirements in effect.

Mandates reimbursement claims are filed with the Commission for the prior fiscal year – after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the next fiscal year. For example, local costs incurred in 2010-11 will be reported and claimed in 2011-12, and the state will reimburse locals for these costs in the 2012-13 budget.

Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment. For example, several elections-related mandates were suspended for the first time in the 2011-12 budget – this means the activities for locals are optional in 2011-12 and locals cannot claim reimbursement for any new costs incurred in 2011-12. However, the mandate claims for these costs in 2009-10 and 2010-11 are still due – either over time, or all at once in a year when the mandate suspension is lifted.

The State owes local governments approximately $1.6 billion in non-education mandate payments. Of this, about $900 million is associated with pre-2004 mandate claims.

GOVERNOR’S PROPOSAL:

The Governor’s Budget proposed expenditures of $52.9 million ($50.4 million General Fund) related to non-education mandates, and this includes $1.5 million for the staff of the Commission. The Governor’s budget would continue to fund the 12 mandates that were kept in force for 2011-12, and that makes up the bulk of the General Fund cost – a list of those mandates is below.

Proposed Mandate Funding in Governor's Budget—General Fund
(Mandates to stay in effect, with reimbursement required)

Mandate Title	Amount (1,000s)
Allocation of Property Tax Revenue	$727
Crime Victim's Domestic Violence Incident Reports	167
Custody of Minors-Child Abduction and Recovery	12,999
Domestic Violence Arrests and Victim's Assistance	1,374
Domestic Violence Arrest Policies	7,608
Domestic Violence Treatment Services	1,944
Health Benefits for Survivors of Public Safety Officers	1,695
Medical Beneficiary Death Notices	10
Peace Officer Personnel Records	657
Rape Victim Counseling	349
Sexually Violent Predators	20,963
Threats Against Police Officers	26
Unitary Countywide Tax Rates	267
Total	**$48,786**

Repeal of Mandates. The Governor does not propose to reactivate any mandates, but would repeal 32 of 56 currently suspended mandates. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code and provides more certainty to local governments.

Budget Savings. The Governor scores a total of $828 million in mandate savings from maintaining mandate suspensions – or repealing those suspended mandates, and by continuing other savings measures. The savings breakdown is as follows: (1) savings of $99.5 million by deferring payment of pre-2004 mandate claims; (2) savings of $295.1 million by deferring payment of post-2004 mandate claims for mandates that have since expired or been repealed; (3) savings of $375.7 million by continuing the suspension of certain local mandates, or repealing them; and (4) savings of $58.0 million from keeping employee-rights mandates in effect, but deferring payment. Under (3) above, 56 mandates are proposed for continued suspension or repeal – excepted are the 12 mandates listed above related to law enforcement and tax collection.

ISSUES TO CONSIDER:

The Governor's mandate proposal is a continuation of the status quo in terms of mandates in effect and mandates not in effect. The big difference in this year's proposal is the Governor's request to amend statute to repeal 32 of the 56 mandates currently suspended. The difference between suspension and repeal does not affect budget savings because in either case the activity becomes optional for local governments and the state does not have to reimburse costs. The argument for repeal is that if the mandate will continue to be suspended in the foreseeable future, the statutory provisions should reflect that the activity is no longer required. Since the list is long, the 32 mandates are not listed here, but are included in the back of this report.

In considering the proposal to repeal 32 mandates, the Legislature can consider whether the activity is a high-priority for the State budget, or will in a future year rise to that level when the state's budget is improved. Additionally, the Legislature can consider that locals government have themselves placed a high priority on some of these activities and will in many cases continue the functions regardless of whether the State reimburses the costs.

General Obligation Bonds

BACKGROUND:

The State uses general obligation bonds (GO bonds) to borrow funds for spending – primarily on capital infrastructure. Bonds must be approved by voters and bond proceeds are either continuously appropriated (immediately available for expenditure) or require a legislative appropriation. All bond debt service is continuously appropriated and, therefore, not appropriated in the annual budget bill. According to the Administration, the State has $81.0 billion in outstanding GO bond debt (including self-liquidating bonds like the Economic Recovery Bonds). Another $35.3 billion in bonds are authorized, but unissued. In most instances, bonds are sold at different lengths of maturity such that repayment is spread over about 30 years.

General Obligation Bonds Authorized but not Issued

Bond Program	**Unissued Amount (in millions)**
Prop 1B of 2006: Transportation	$11,080
Prop 1A of 2008: High Speed Rail	9,448
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	3,362
Prop 84 of 2006: Safe Drinking Water	2,957
Prop 71 of 2004: Stem Cell Research	1,873
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,819
Prop 46 of 2002 & Prop 1C of 2006: Housing	1,392
All other	3,372
TOTAL	**$35,303**

The State generally goes to market to sell GO bonds once in the spring and once in the fall. Bonds are sold to meet expenditure needs plus an additional cash cushion to account for uncertainty about how fast projects will expend funds and uncertainty about the timing of the next bond sale. As of December 2011, about $9.7 billion in bond cash was on-hand from prior bond sales. The table below shows cash on-hand by bond for some of the major bond acts.

General Obligation Cash Proceeds

Bond Program	Cash, or bond proceeds, as of Dec 2011 (in millions)
Prop 1B of 2006: Transportation	$2,241
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	1,501
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,445
Prop 84 of 2006: Safe Drinking Water	1,291
Prop 46 of 2002 &Prop 1C of 2006: Housing	654
Prop 71 of 2004: Stem Cell Research	187
Prop 1A of 2008: High Speed Rail	216
All others	2,166
TOTAL	**$9,701**

GOVERNOR'S PROPOSAL:

Expenditure of bond proceeds is reflected in the budgets of individual departments, but the payment of bond debt is consolidated in item 9600 in the Governor's Budget. It is the repayment of bond debt that is reflected as a General Fund expense. Some bond costs are offset by special funds or federal funds. Other bonds are "self liquidating," or have their own dedicated revenue (i.e., the Economic Recovery Bonds [ERBs] receive a quarter-cent of the sales tax).

The January Governor's Budget includes $4.6 billion in General Fund costs for GO bond debt service and related costs, or a total of $6.1 billion when the cost of Economic Recovery Bonds is included. In addition to this amount, $717 million in debt costs are funded from special funds (i.e., $703 million from transportation special funds is used to pay transportation-related bond debt). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide $352 million in 2012-13.

Governor's Budget for GO Bond Debt
(Dollars in millions)

	2010-11 Actual Cost	2011-12 Estimated Cost	2012-13 Estimated Cost
General Fund cost	$4,747	$4,649	$4,612
Other funds cost	732	679	717
Federal subsidy (Build America Bond Program)	298	351	352
TOTAL Item 9600	**$5,777**	**$5,679**	**$5,681**
Economic Recovery Bonds (ERBs, not included above because indirect GF cost)	$1,263	$1,341	$1,465

The Governor's proposed budget includes $92.6 billion in General Fund expenditure, so the net General Fund bond debt service as a percentage of General Fund expenditures is 5.0 percent (or 6.6 percent when ERBs are included).

Economic Recovery Bonds are not included directly in General Fund costs for bond debt service. Repayment of those bonds is financed from a quarter cent sales tax that was temporarily redirected from local government. Local government revenue is backfilled from the State General Fund through Proposition 98 education funding. The budget reflects special fund expenditures of $1.5 billion for ERB debt service in 2012-13, and the Proposition 98 budget reflects increased General Fund expenditures of $1.4 billion. The difference is due to timing issues and also the fact that revenue from surplus property sales is also used to accelerate ERB repayment.

The budget plan includes an assumption that $2.4 billion in GO bonds will be sold in the spring of 2012, and that $2.9 billion will be sold in the fall of 2012. Among these planned sales are $2.4 billion for Proposition 1B (transportation) and $1.9 billion for various education facility bonds.

ISSUES TO CONSIDER:

Budget and Bonds

Paying GO bond debt is a significant General Fund expense of about $6.1 billion; however, the use of bonds to accelerate capital projects is a commonly-used practice of government entities. To the extent bond costs do not exceed a government's long-term ability to fund other commitments, they allow the public to enjoy the benefits of infrastructure investment more quickly. Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. The bonds have allowed the state to invest in infrastructure while the need for economic stimulus is most acute, while borrowing costs are low, and while construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. A $1 billion bond generates annual bond debt costs of about $65 million over a 30-year period. That bond cost crowds out alternative expenditures over the life of the bond. The Legislature can prioritize or limit bond funding through the budget process as overall expenditures are prioritized.

Management of Bonds

As the State's cash situation deteriorated with the most recent recession, the Administration changed the methodology for managing bond cash. Prior to the recession, reserve cash funded project costs in advance of bond sales, and then bond sales replenished cash reserves. When reserve cash declined, the state had to instead sell bonds in advance of expenditures. Due to project expenditures happening slower than anticipated at the time of bond sales, large bond cash balances have developed – about $9.7 billion as of December 2011. Last year, the Administration implemented a plan to utilize commercial paper to aid cashflow, and reduce the need to carry large bond cash balances. Progress has been made to reduce bond cash, but balances are still higher than desired. At budget hearings, the Administration should be prepared to discuss their management of bond proceeds and forecasts of project expenditures.

Budgetary Borrowing and Loan Repayment

BACKGROUND:

Through budget actions over the last decade, the State has borrowed from special funds and deferred payments to close budget deficits. The Department of Finance indicates a total of $33.5 billion in loans and deferrals have accumulated and remain unpaid. The Governor defines this as the "wall of debt," and includes in his definition adjustments related to his budget proposals. Some obligations require repayment in specified years due to constitutional requirements or due to scheduled bond debt service – examples of rigid repayment requirements are a payment of $2.1 billion in 2012-13 for "Proposition 1A" local-government borrowing and an Economic Recovery Bond payment of $1.4 billion also in 2012-13. Other debt payments are more flexible, for example school payment deferrals and special fund loans can be repaid over time as the budget situation dictates. In either case, the wall of debt represents a budget challenge as these accumulated debts make it more difficult to fund ongoing program costs.

GOVERNOR'S PROPOSAL:

The Governor proposes to pay down $6.9 billion of the $33.5 billion wall of debt in 2012-13. The Governor's multi-year budget plan assumes voter approval of his tax initiative and if that occurs, his plan would fully repay wall-of-debt obligations by the end of 2015-16. If this plan were to be realized, the 2016-17 budget and ongoing budgets would be free of these debt pressures and expenditures would be more in line with annual revenues.

Governor's Wall of Debt and Proposed Repayment
(Dollars in Millions)

Wall of Debt Item	Outstanding Balance	Proposed Repayment in 2012-13
Deferred Payments to Schools	$10,430	$2,369
Economic Recovery Bonds	6,081	1,362
Loans from Special Funds	3,101	486
Mandate Debt to Local Governments	4,472	0
Underfunding of Proposition 98	4,113	462
Proposition 1A Borrowing from Local Governments	2,095	2,095
Deferred Medi-Cal Costs	1,625	0
Deferral of State Payroll Costs	759	0
Deferred Payments to CalPERS	501	0
Proposition 42 Borrowing from Transportation Funds	334	83
Total	**$33,511**	**$6,857**

The payments related to schools are discussed in the education section of this report. The planned payments for Economic Recovery Bonds, Propositions 1A borrowing, and Proposition 42 borrowing are constitutionally required or dictated by bond debt service. The payment of loans from special funds, is more discretionary. In fact, the base budget, or workload budget, assumed total loan repayment of $1.1 billion in 2012-13, but the Governor proposes to defer payment of $631 million of that outstanding debt until future years. The amount of special-fund loans proposed for repayment is $486 million, plus interest costs of $39 million. The Administration indicates repayment of these loans is necessary to support 2012-13 expenditures in those departments funded with the associated special fund revenue. Interest is required on most special fund loans and is paid when the principal is repaid.

Governor's Proposal for Repayment of Special Fund Loans
(Dollars in Millions)

Affected Department and Special Fund	Principal Amount	Interest Amount
Technology Agency – State Emergency Telephone Number Account	$28.0	$0.2
Consumer Affairs – Behavioral Science Examiners Fund	2.0	0.5
General Services – Public School Planning Revolving Fund	10.0	1.3
Housing and Community Development – Joe Serna, Jr. Farmworker Housing Grant Fund	2.5	0.3
Housing and Community Development – Rental Housing Construction Fund	0.5	0.1
Transportation – State Highway Account	135.0	5.6
Conservation – Collins-Dugan California Conservation Corps Account	2.0	0
California Energy Commission – Renewable Resources Trust Fund	64.1	7.2
California Energy Commission – Alternative and Renewable Fuel and Vehicle Technology Fund	8.3	0.3
Cal Recycle – California Beverage Container Recycle Fund	171.7	13.8
Public Utilities Commission – California Teleconnect Fund	61.8	9.3
Total	**$485.9**	**$38.6**

ISSUES TO CONSIDER:

The Governor's emphasis on repaying budgetary debt over the next four years is good fiscal policy that also complements his initiative to temporarily increase taxes for four years. Clearing $33.5 billion in budgetary debt while temporary taxes are in place will reduce spending pressures after the taxes expire. While some of the Governor's debt repayment is constitutionally mandated in 2012-13, other debt can be considered within the context of the Legislatures other budget priorities. However, due to the budget gap, it would be difficult to accelerate debt repayment beyond the level proposed by the Governor. In considering repayment of special fund loans in 2012-13, and beyond, the Legislature should consider the expenditure needs of the affected departments and programs. Some department may have deferred capital projects or maintenance that can be accelerated by early loan repayments. Other departments may not have spending pressures, and funds from repaid loans may result in surplus reserves over a period of many years.

Cash Management

BACKGROUND:

Because receipts and disbursements of cash occur unevenly throughout the fiscal year, the General Fund borrows for cashflow purposes in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes [RANs]). An additional tool in managing cash is deferrals of payment within the fiscal year to universities, local governments, and other entities. In recent years, flexible deferrals have been enacted in statute that allows specified deferrals if necessary to maintain a prudent balance for bond debt and other priority payments.

GOVERNOR'S PROPOSAL:

The Governor's proposal includes funding for the interest costs of cashflow borrowing from special funds and from RANs. The budget includes $178 million General Fund for these interest costs. In addition to interest costs, which are continuously appropriated (RANs) and appropriated in the budget bill (special fund cash loans), the Governor proposes statutory change that would allow additional special funds to be authorized for cashflow borrowing and statutory change to continue flexibility to defer specified payments if needed for cash management. These statutory flexibilities are similar to what current law provides for 2010-11 and 2011-12.

Cashflow borrowing. The Administration proposes to make seven special funds eligible for cash borrowing, which would provide about $865 million of new borrowable resources. Five of the seven funds are transportation special funds which were restricted in use by Proposition 22 on the 2010 ballot. The proposed changes would further the purpose of Proposition 22, by providing new benefits and flexibility for transportation funds – specifically emergency borrowing authority in the case of delayed bond sales, and guaranteed allocations to local governments even in the case of late budgets. Proposition 22 funds would be made borrowable to provide a $625 million cashflow benefit. The other two special funds that would be available for cash borrowing are the Condemnation Deposits Fund and the Health Care Deposit Fund. All cashflow borrowing is managed so that programs supported by the special funds are completely unaffected.

Flexible Payment Deferrals. The proposed legislation to continue payment-deferral flexibility would provide over $3.4 billion in cashflow relief. The deferral plan was developed in consultation with higher education and local governments to minimize negative consequences. Finally, the plan includes triggers, such that the deferrals will not occur if the team of the State Treasurer, the State Controller, and the Director of Finance concur they are not necessary to maintain cash balances for the State. The following are the major statutory components:

- K-12 Education – Permits deferrals in specified months with specified repayment dates. The amount deferred in any period prior to repayment cannot exceed $1.9 billion. Includes a hardship-exemption process for certain local education agencies.
- Community College – Permits deferrals up to $300 million.
- California State University – Permits deferrals of up to $250 million, and specifies smoothing of payments to the California State University such that the monthly payments in July through April do not exceed one-twelfth of the annual amount.
- University of California – Specifies smoothing of payments to the University of California such that the monthly payments in July through April do not exceed one-twelfth of the annual amount.
- Cities and Counties – Permits deferrals of specified payments to local governments not to exceed $1 billion.

ISSUES TO CONSIDER:

Authorizing additional special funds for cashflow borrowing is good fiscal policy that reduces the need for more expensive external borrowing. While cash deferrals to other government units are not desirable, the flexibility to do so may be necessary for 2012-13 to maintain a prudent cash cushion that is need to obtain external borrowing. Deferrals to public entities also ensure payments to private vendors and tax refunds will not be delayed. The Governor's plan to reduce the wall of debt will help the state's cash management and reduce the need for payment deferrals in the future.