Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Janet Nguyen
Senator Richard Pan

Wednesday, March 30, 2016
10:30 a.m.
State Capitol - Room 3191

Consultant: Mark Ibele

PART A

ITEMS PROPOSED FOR VOTE-ONLY

ITEMS FOR DISCUSSION AND VOTE

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ISSUES PROPOSED FOR VOTE ONLY

0509 GOVERNOR' OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Issue 1: Zero Emission Vehicle Infrastructure Project

Governor's Proposal. The Governor's Office of Business and Economic Development (GO-Biz) is requesting to extend funding for one position and increase reimbursement authority by $150,000 in 2015-16 and $150,000 in 2016-17. This request provides resources for the Zero Emissions Vehicle (ZEV) Infrastructure Project Manager (IPM) position related to state efforts to meet the requirements of several federal and state air quality and emission reduction mandates. The limited-term position will assist projects in obtaining local and state permits and develop and oversee a high level stakeholder working group dedicated to developing ZEV fueling and charging stations throughout the state. The funding is provided through an interagency agreement between GO-Biz and the California Energy Commission (CEC).

Background. Legislation adopted in 2007 established three new programs intended to promote vehicle and fuel technology that reduce air pollution and greenhouse gas emissions statewide. Subsequent actions expanded California's clean air and clean vehicle incentive programs in order to meet clean air, public health, climate and economic development goals. This later legislation requires the CEC to fund the development of up to 100 hydrogen fueling stations from vehicle registration fee revenues in the total amount of up to $220 million over the next 10 years. Since 2009, 45 hydrogen fueling station projects have been funded by Alternative and Renewable Fuel and Vehicle Technology Program (ARFVTP) funds.

Prior to the funding of the IPM position, the construction of fueling stations had experienced delays due to issues related to siting, permitting, finances, California Environmental Quality Act (CEQA) requirements, and certification. Some auto manufacturers (Toyota, Mercedes-Benz/Daimler, Hyundai, Nissan, and GM) are planning to introduce fuel-cell hydrogen vehicles in California in the next few years; however, the existing seven-station network is not positioned to meet the demands of new customers. A shortage of hydrogen fueling stations could discourage the manufacture of hydrogen fueled vehicles, and potentially put at risk the timely attainment of air quality and emissions goals for the state. To further the development of the fueling infrastructure, the ZEV IPM was administratively established in 2013. In June 2015, the CEC Business Committee approved funding to GO-Biz to extend the position for two additional years.

Staff Comments. With the proposed extension of the ZEV IPM position, the continued staff responsibilities include working with: 1) individual communities and station developers, to expedite siting and permitting; and, 2) stakeholders, to ensure that the state is proceeding on developing a robust hydrogen fueling network.

Staff Recommendation. Approve as budgeted.

Vote.

0984 California Secure Choice Retirement Savings Investment Board

Issue 1: Reappropriation of Existing Funding

Governor's Proposal. The Administration proposes a reappropriation of the remainder of the balance of its fiscal year 2015-16 appropriation (estimated to be $200,000) and provisional language for additional expenditure authority upon Department of Finance (DOF) approval and notification to the Legislature. The funds will be used to conduct remaining legal analysis for the implementation of the California Secure Choice Retirement Saving Program (CSCRSP). As with the current year requirement, the additional spending authority proposed for 2016-17 is based upon the receipt of federal funds and donations through a non-profit or private entity.

Background. The California Secure Choice Retirement Savings Investment Board and the CSCRSP were established pursuant to SB 1234 (De León), Chapter 734, Statutes of 2012, for the purpose of creating a statewide savings plan for private-sector workers who lack access to an employer-sponsored retirement savings plan. The legislation requires that the board conduct a market analysis, financial feasibility study and legal analysis to determine whether the necessary conditions for implementation of the program can be met. The board was required to conduct the analyses only if funds were made available through a nonprofit or private entity, or from federal funding. Adequate funding was received for these purposes. The board can implement the program only if it determines, based on the market analysis, that the program will be self-sustaining; funds are made available through a nonprofit or other private entity, federal funding, or an annual budget act appropriation, in amounts sufficient to allow the board to implement the program until the California Secure Choice Retirement Savings Trust has sufficient funds to be self-sustaining; and an authorizing statute is enacted that expresses the approval of the Legislature for the program to be fully implemented. The board has entered into an agreement with a firm for market analysis, financial feasibility study, and program design work. In addition, the board entered into an agreement with a firm for legal services. The board expects both studies to be completed by spring 2016.

Staff Comments. Support for the program must come from donated funds. Staff has no concerns with the proposal.

Staff Recommendation. Approve as budgeted.

Vote.

ISSUES FOR DISCUSSION AND VOTE

BUDGETARY ROLE OF STATE RESERVE FUNDS

Presenters: Department of Finance
Legislative Analyst's Office

Background. The state has two reserve funds—the Special Fund for Economic Uncertainties (SFEU) and the Budget Stabilization Account (BSA).

- The SFEU is the state's general reserve used to provide resources for unexpected costs relating to one-time events such as legal decisions or program cost overruns. The SFEU is a discretionary reserve from which the Legislature may appropriate funds at any time and for any purpose.

- The BSA is a restricted account, with specific rules governing how and when the state must make deposits into or may make withdrawals from the fund. Withdrawals are limited to situations involving budgetary emergencies called by the Governor if financial resources fall short or natural disasters occur.

Proposition 2, adopted by the voters in 2014, tightened-up the existing BSA (and addressed debt payments) through constitutional requirements. The constitutional measure: requires the state to annually set aside of 1.5 percent of General Fund revenues plus capital gains-related taxes in excess of eight percent of General Fund revenues; directs one-half the set-aside funds to the BSA and one-half towards paying-off accumulated debts and liabilities; caps the BSA at an amount equal to 10 percent of General Fund Revenues (currently about $12 billion); restricts withdrawals from the account to hardship situations (defined as budget shortfalls or natural disasters); limits funds that would otherwise be deposited to the BSA to infrastructure investment, once the maximum level is reached. The language also requires that the estimate on required capital gains-related taxes deposits be 'trued-up' in the two subsequent years after the initial deposit to account for the difference between the estimates amount and actual revenues received.

In certain situations, 'excess' funds held in the SFEU could cause a reduction in revenues received from the sales and use tax. California has two statutes that trigger reductions in the state's sales tax rate if balances in the SFEU reach a certain threshold. The state's sales tax rate would automatically decline by one-quarter cent for one calendar year (currently equal to around $1.5 billion), if: 1) the Director of Finance projects the SFEU to exceed about four percent of General Fund revenues (currently, about $5 billion) in the prior and current year; or, 2) if both the General Fund reserves exceed about three percent of revenues (currently $4 billion) and actual General Fund revenues between May 1st and September 30th exceed the Administration's forecasted amounts.

Governor's Proposal. The 2016-17 budget includes total constitutionally-required deposits to the BSA of $2.6 billion ($1.0 billion true-up for 2015-16 and $1.6 billion initial deposit for 2016-17). In addition to these balances, the Governor proposes increasing reserves by $3.1 billion.

This amount includes an increase in the balance of the SFEU by $1.1 billion and an optional deposit of $2.0 billion into the BSA. Under this proposal, the SFEU balance would grow to $2.2 billion, and the BSA balance would grow to $8.0 billion. Under the Governor's plan, by the end of 2016-17 reserves would total $10.2 billion, assuming current fiscal projections.

The $2.0 billion optional BSA deposit would be subject to the rules of Proposition 2, in that this deposit would be accessible only in a budget emergency, and access would be limited to half of these funds in the first year of a budget emergency. The Governor also proposes that the Legislature use the $2.0 billion optional BSA deposit for meeting reserve requirements for 2015-16 and 2016-17 that exceed current estimates. That is, these funds would be available in the June 2015 budget plan or in future budgets to cover higher BSA deposit requirements. If future revisions and true ups are less than $2.0 billion, the Administration proposes that the outstanding funds remain in the BSA.

Legislative Analyst's Comments. The Legislative Analyst's Office (LAO) has raised a number of concerns with the Governor's proposal. The primary concern expressed by LAO is that the additional $2 billion discretionary deposit to the BSA would restrict the use of these funds to those purposes stipulated by the Constitution under Proposition 2. Absent this deposit, the Legislature could retain much more discretion over the use of these revenues—including retiring long-term liabilities, providing additional program funding, or providing advance-funding of General Obligation bond debt service. (The later policy would free-up an equivalent amount of cash in the future.) LAO also notes that the discretionary funds may not be allowable as 'pre-funding' of potential future required deposits to the BSA, as this designation may not be allowable under the Constitution. LAO has proposed some approaches to funding reserves the Legislature may want to consider.

Staff Comments. The issue state reserves raises vital questions regarding the most appropriate use of taxpayer funds and the adequate funding of state programs during periods of fiscal stress. In its consideration of these questions, the committee could weigh the risks of potential economic and budgetary downturns (and the need to protect against these) with putting public funds towards their highest and best use. Among issues for consideration by the committee, are the following:

- The most efficient use of 'one-time' revenues, including for reserves, program needs, capital investment and advanced payment of obligations.

- The appropriate magnitude of aggregate reserve funds, given fiscal risks and program demands.

- The most advantageous and flexible allocation of surplus revenues among the state reserve funds.

Staff Recommendation. Hold open.

PROPOSITION 2 DEBT PAYMENT PLAN

Presenters: Department of Finance
Legislative Analyst's Office

Background. Proposition 2, adopted by the voters in 2014, tightened reserve and debt payment requirements by obligating the state to annually set aside of 1.5 percent of General Fund revenues plus capital gains-related taxes in excess of eight percent of General Fund revenues. The Constitution requires that one-half of the set-aside funds be deposited to the BSA and one-half towards paying-off accumulated debts and liabilities. These minimum debt payments are mandatory through 2029-30, and optional after that time. (After 2019, payments not made toward debts would be required to be deposited in the BSA.)

The debts the state can pay out of the Proposition 2 designated funds include special fund loans, Proposition 98 'settle-up' payments, and unfunded pension and retiree health liabilities (including those of the University of California and California State University). Unlike the deposit to the BSA, which may be reduced or suspended in a budget emergency, the state may not reduce or suspend required debt payments. The state currently has substantial debts that would qualify under Proposition 2, as shown in the following table:

Proposal for Debt and Liabilities Payments
(Dollars in Millions)

Category	Amount Beginning of 2016-17	Payment in 2016-17
Budgetary Borrowing		
Special Fund Loans and Interest[1]	$1,806	$955
Proposition 98 Settle-Up Underfunding[1]	1,232	257
Transportation Loans (Pre-Proposition 42)[1]	879	173
Subtotal Debt	**3,917**	**1,385**
Retirement Liabilities		
State Retiree Health	71,773	-
State Employee Pensions	43,291	-
Teacher Pensions	72,718	-
Judges' Pensions	3,358	-
CalPERS Deferred Payment	570	
UC Employee Pensions[1,2]	10,786	171
UC Retiree Health[2]	17,270	-
Subtotal Liabilities	**219,766**	-
Grand Total	**$223,683**	**$1,556**

[1] Payment under Proposition 2.
[2] Not a state government liability.

The state has plans in place to address some debt—such as those obligations associated with California Public Employees Retirement System (CalPERS) and California State Teachers Retirement System (CalSTRS). Other debt has yet been addressed in a comprehensive fashion, including obligations associated with public employees' retiree health care, judges' pensions, and UC retirement debts. As noted by the Legislative Analyst's Office (LAO), the debt eligible for Proposition 2 funding carry various annual interest rates, ranging 7.5 percent for some retirement liabilities down to zero percent for 'settle-up' payments to schools. LAO also notes that payment of these debts can benefit very different groups and institutions.

Governor's Proposal. The Proposition 2 debt proposal for the budget focuses largely on special fund loans, which account for $1.1 billion of the $1.6 billion in resources available for debt payments. Interest on the budgetary loans is budgeted through Item 9620. Loan payments proposed in the budget are listed in the following table:

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

Fund Name	Amount
Unemployment Compensation Disability Fund	$308.2
Transportation Congestion Relief Fund	173.0
Off Highway Vehicle Trust Fund	112.0
Greenhouse Gas Reduction Fund	100.0
School Land Bank Fund	59.0
Harbors and Watercraft Revolving Fund	51.0
Hospital Building Fund	50.0
Oil Spill Response Trust Fund	40.0
Housing Rehabilitation Loan Fund	35.4
Accountancy Fund	21.0
State Corporations Fund	18.5
Tax Credit Allocation Fee Account	13.0
State Board of Barbering and Cosmetology Fund	11.0
Vehicle Inspection Repair Fund	10.0
Enhanced Fleet Modernization Subaccount	10.0
Psychology Fund	6.3
Behavioral Science Fund	6.3
Contingent Fund of the Medical Board of California	6.0
Firearms Safety and Enforcement Special Fund	4.9
Acupuncture Fund	4.0
Professional Engineers' and Land Surveyors' Fund	3.2
Private Postsecondary Education Administration Fund	3.0
Real Estate Appraisers Regulation Fund	3.0
Registry of Charitable Trust	2.7
Environmental Water Fund	2.4

Antiterrorism Fund	2.0
Drinking Water Operator Certification Special Account	1.6
Private Investigator Fund	1.5
Physician Assistant Fund	1.5
Osteopathic Medical Board of California Contingent Fund	1.4
California Water Fund	1.1
State Optometry Fund—Professions and Vocations	1.0
Total	**$1,064.0**

In addition to the pay-down of budgetary loans (constituting the overhang of debt from the prior Administration), the Governor proposes to pay $257 million towards the Proposition 98 'settle-up' owed to schools and $171 million payment towards UC retirement liabilities.

Legislative Analyst's Comments. In its review of the Governors' Proposition 2 debt pay-down proposal the LAO makes several observations regarding the focus and implication of the approach. LAO notes that the Governor's plan focuses on paying off budgetary debt to special funds, which carry low or no interest rates, as opposed to paying retirement liabilities, which carry much higher interest rates. The LAO notes that schools would benefit—in a relatively minor fashion—from the proposed plan, as well as potentially special fund fee payers. The implication of the plan is that taxpayers, in general, could be better off from a plan that focused on retiring high-interest loans rather than low-interest budgetary loans. LAO proposes an alternative approach which basically incorporates this notion. It also suggests that a long-term plan be adopted that addresses all the state outstanding debts in a comprehensive fashion.

Staff Comments. The Administration's efforts to retire budgetary debt to special funds are understandable. The repayment may put programs financed by these funds in a better fiscal position and potentially be more effective in fulfilling their responsibilities. In addition, given that these funds remain borrowable resources, to the extent that outstanding loans are repaid, the funds would be restored as resources for General Fund borrowing in the event of future fiscal stress. LAO's perspective regarding a repayment plan which focuses on paying off high interest debt first, is reasonable; however, it also raises a logical question as to why, using the same logic, the state should not 'play the spread' and borrow as much as available from special funds to pay down the retirement liabilities. Staff also notes that paying budgetary loans potentially retains these funds as borrowable resources; paying-down retirement-related liabilities is irreversible. The committee may want to consider the following related issues:

- The advantages and disadvantages of paying off special fund loans versus reducing retirement liabilities.

- The relative benefits to taxpayers at large and publicly-provided programs from different debt payment plans.

- The degree of state fiscal flexibility that may be restricted or enhanced through different debt payment plans.

- The extent to which the state should maximize the opportunity to borrow at interest rates lower than the rate on existing debt obligations.

Staff Recommendation. Hold open.

0509 GOVERNOR'S OFFICE OF BUSINESS AND ECONOMIC DEVELOPMENT

Department Overview. The Governor's Office of Business and Economic Development (GO-Biz) provides a single point of contact for economic development, business assistance and job creation efforts. GO-Biz works with companies and organizations across the nation to market the benefits of doing business in California, recruit new businesses, retain businesses, and support private sector job growth. GO-Biz serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, economic growth, export promotion, permit assistance, innovation and entrepreneurship. GO-Biz consists of the following programs:

- **GO-Biz** serves as the Governor's lead entity for economic strategy and the marketing of California on issues relating to business development, private sector investment, and economic growth, and export promotion. This program makes recommendations to the Governor and the Legislature regarding policies, programs, and actions for statewide economic goals.

- **California Business Investment Services** serves employers, corporate executives, business owners, and site location consultants which are considering California for business investment and expansion. This program works with local, state, and federal partners in an effort to attract, retain, and expand businesses. The Innovation Hub (iHub) initiative is an effort to improve the state's national and global competitiveness by stimulating partnerships, economic development, and job creation around specific research clusters.

- **Office of the Small Business Advocate (OSBA)** serves as the principal advocate in the state on behalf of small businesses, including regarding legislation and administrative regulations that affect small business. The OSBA is responsible for disseminating information about programs and services provided by the state that benefit small businesses, and how small businesses can participate in these programs and services. The OSBA responds to issues from small businesses concerning the actions of state agencies, state laws and regulations adversely affecting those businesses. The OSBA maintains and distributes an annual list of persons serving as small business ombudsmen throughout state government.

- **California Film Commission (CFC)** provides significant financial assistance through its publically-funded tax credit program. The purpose of the CFC is to retain and increase motion picture production in the state. The CFC supports productions by issuing film permits for all state properties, administering the film and TV tax credit program, maintaining a location library, and offering production assistance on a wide variety of issues. CFC also works with cities and counties with the goal of creating 'film friendly" policies that are consistent state wide.

- **California Tourism Market Act** provides for the marketing of California through an assessment of businesses that benefit from travel and tourism. The objective of the Tourism Assessment Program is to identify potentially assessable businesses, assist companies with determining the appropriate amount of their self-assessment, and collect the fee.

- **California Infrastructure and Economic Development Bank (IBank)** was created to finance public infrastructure and private development that promotes economic growth. IBank has a broad authority to issue tax-exempt and taxable revenue bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage state and federal funds. IBank's current programs include the infrastructure state revolving fund, 501(c)(3) tax-exempt and taxable revenue bond program, industrial development revenue bond program, exempt facility revenue bond program, governmental bond program and the Clean Energy Finance Center (CEFC) and the Statewide Energy Efficiency Program under the CEFC.

- **Small Business Loan Guarantee Program (SBLGP)** promotes local economic development by providing guarantees for loans issued to small businesses from financial institutions, typically banks, which otherwise would not approve such term loans or lines of credit. The loan guarantee serves as a credit enhancement and an incentive for financial institutions to make loans to small businesses that otherwise would not be eligible for such financing.

- **California Welcome Centers** are visitor information centers that are accessible to and recognizable by tourists, and are designed to encourage tourism in California and provide benefits to the state economy. The objective of the California Welcome Center Program is to determine the locality of underserved travelers, designate a welcome center, and establish operating standards across the network.

Budget Overview. The department has expanded modestly over the recent past, due both to program expansions (such as the California Competes program discussed below) and through the inclusion of other existing program (such as the IBank). The department's budgets (and positions) for the prior, current and budget years are shown in the tables below.

Governor's Office of Business and Economic Development
Program Expenditure
(dollars in thousands)

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Go-Biz	$2,758	$4,626	$4,943
California Business Investment Services	1,782	1,731	1,832
Office of the Small Business Advocate	2,151	2,480	287
Infrastructure, Finance and Economic Development	25,602	17,013	38,167
Total Expenditures	**$32,293**	**$25,850**	**$45,229**

Governor's Office of Business and Economic Development
Position Authority
(actual positions)

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Go-Biz	24.0	23.0	22.0
California Business Investment Services	11.0	9.4	9.0
Office of the Small Business Advocate	2.2	2.5	6.0
Infrastructure, Finance and Economic Development	34.2	31.4	45.4
Total Positions	**71.4**	**66.3**	**82.4**

Issue 1: California Competes Tax Credit Program – Oversight

Presenter: **Governor's Office of Business and Economic Development**
Legislative Analyst's Office

Background. The California Competes Tax Credit (CCTC) is a targeted tax credit program administered by GO-Biz and the Franchise Tax Board (FTB). In its administration of the CCTC, GO-Biz is responsible for a relatively new program that involves a sizeable commitment of state funds, in the form of revenues foregone, over several years. The funds 'flow' is based on negotiated contracts with private companies. The purpose of the CCTC is to attract, expand, and retain businesses in California. Business entities that apply for the credit are evaluated on the basis of number of employees; jobs created or retained; location of the company in the state; and magnitude of new investment. The tax credit packages are negotiated between the business and the Administration (GO-Biz) and then voted on by the GO-Biz committee, consisting of the director of GO-Biz, the director of the Department of Finance, the State Treasurer, and one appointee each from the Senate and the Assembly.

Taxpayers may receive a maximum of 20 percent of the total amount of credits available for a particular year. In addition, 25 percent of the available credits must be provided to small businesses (companies with gross receipts of $2 million or less). The amount of credits that is allocated is up to $30 million in 2013-14, $150 million in 2014-15 and $200 million for years 2015-16 through 2017-18. These amounts may be reduced in order to ensure the total amount of tax reductions resulting from the program and two other tax preference programs (sales and use tax exemption for certain capital investments and new hiring tax credit) is no greater than $750 million in a fiscal year.

The implementation of the program is defined based on the application process, evaluation process, negotiation process and committee process, as described below:

- **Application Process.** During this stage of the program, CCTC staff engages in in one-on-one contact with applicants and their designated representatives by providing assistance with computing and entering the required information. CCTC staff also confirms eligibility, explains regulations, recommends other resources and provides information about deadlines.

- **Evaluation Process.** The evaluation process is two-phased. The initial phase calculates the cost-benefit ratio from the state's perspective, based on the credit request, aggregate employee compensation, and aggregate investment. The most completive proposals move to the second evaluative phase. The second phase involves looking at specific selection criteria, including number of jobs, amount of investment, extent of unemployment and poverty in the project area, and opportunity for additional growth.[1]

- **Negotiation Process.** Contract negotiations require a significant amount of analysis and discussion between CCTC staff and the applicant. The intent is to reach specific agreements that create definitive milestones, explain agreement provisions, and tailor language specific to the project.

- **Committee Process.** At this stage, CCTC staff briefs committee members and presents the negotiated agreements for approval at a public hearing. It also informs the FTB of the approved items and conditions of the agreements and posts information on the awards to the website.

Go-Biz has also pursued significant economic development proposals outside of the AB 93 framework with mixed success, specifically: Lockheed Martin tax credit ($420 million over 15 years); Northrup Grumman tax credit (accompanying measure); film tax credit extension/expansion (more than $1.5 billion over five years); and the Tesla 'gigafactory'. The Administration deemed these agreements as too substantial to occur within the AB 93 parameters and pursued them as independent pieces of legislation. Nevertheless, the potential sizeable commitment of additional foregone General Fund resources was not contemplated as part of the AB 93 conversation.

Staff Comments: While programs similar to the CCTC are used in other states with varying degrees of success, this approach to business development and assistance is not one that California has used in the past. Given this new approach to awarding tax credits, it is important that the Legislature be vigilant in its oversight of the program, to ensure that it is implemented in as effective a manner possible. The committee may wish to have the GO-Biz provide an update on the development and implementation of the program.

One of the underlying problems associated with traditional open-ended tax incentives is that the majority of the tax benefit goes to businesses that would have engaged in the desired behavior irrespective of the incentive program. Put another way, only businesses operating 'on the

[1] The specific criteria are: a) the number of jobs created or retained in the state; b) the compensation paid to employees, including wages and fringe benefits; c) the amount of investment in the state; d) the extent of employment or poverty where the business is located; e) the incentives available to the business in the state; f) the incentives available to the business in other states; g) the duration of the business's proposed project and the duration the business commits to remain in this state; h) the overall economic impact; i) the strategic importance to the state, region or locality; the opportunity for growth and expansion; the extent to which the anticipated benefit to the state exceeds the projected benefit to the business from the tax credit.

margin' would engage in the desired behavior ***because*** of the incentive. The result is a significant loss in revenue with little or no associated impact on economic activity. The GO-Biz CCTC program attempts to eliminate or minimize this loss by targeting its incentives at companies on the margin; its ability to do this, however, is open to question (as it would be for any outside entity attempting to measure internal business investment decisions). One way to measure success in this regard would be to examine companies that met the cost-benefit threshold (initial evaluation phase) and were among the finalists in selected criteria (second evaluation phase), but for one reason or another, were not selected as credit recipient. Unfortunately, there are sizeable information and data gaps that would have to be overcome in order to use this method. Other alternative approaches to measuring effectiveness—including econometric studies—could be used, as well.

As noted above, some of the sizeable initiatives undertaken by GO-Biz have been outside of the parameters established in the legislation establishing the California Competes Tax Credit. In large part, the details surrounding these incentive efforts were provided to the Legislature deep into the legislative session under a compressed schedule, making thorough independent analysis and review very challenging. The committee may consider the value of regular quarterly or biannual meetings with GO-Biz staff, such that leadership is kept current on potential agreements. This could be of particular value for agreements with a significant budgetary impact that could affect the funding of the Legislature's own priorities.

The committee may want to consider the following issues with respect to CCTC, and pose relevant questions to GO-Biz and LAO:

- The need for additional legislative oversight of the CCTC activities with respect to the location of activities and the types of industries approved for support, through a regular institutionalized process.

- The degree to which GO-Biz has been able to channel investment into economically-challenged areas of the state and into activities that provide opportunities to regional residents.

- The extent to which Go-Biz is capable of assessing whether jobs and investment would either not be retained or not created absent the existence of the credit, or whether an independent study should be required.

- The benefits of a comprehensive analysis—by LAO or other independent entity—of the effectiveness of the program to assess what the state has realized in exchange for its investments, prior to any extension of the program.

Staff Recommendation. Informational item.

Issue 2: New Hiring Tax Credit – Oversight

Presenters: **Governor's Office of Business and Economic Development**
Department of Finance
Franchise Tax Board
Legislative Analyst's Office

Background. In 2013, the Legislature authorized the New Hiring Tax Credit (NHTC), which provides a tax credit to employers who: (1) Hire a qualified full-time employee; (2) pay qualified wages attributable to work performed by the qualified full-time employee in a Designated Geographic Area (DGA); (3) receive a Tentative Credit Reservation (TCR) from the Franchise Tax Board (FTB) for that qualified full-time employee, and (4) certify each qualified employee. The qualified employee must be unemployed, a veteran, a recipient of the federal earned income tax credit, or an ex-offender.

The credit is based on 35 percent of qualified wages or wages between 150 percent (or $10 for certain a pilot areas) and 350 percent of minimum wage. At the time the NHTC was chaptered the 2014 qualifying wage range, excluding pilot areas, was between $12 and $28 an hour. This increased to $13.50 and $31.50 with a July 1, 2014 increase in minimum wage. In order to generate an allowable credit, the qualified taxpayer must have a net increase in its total number of full-time employees working in California, when compared to its base year. The credit is available to employers for taxable years beginning on or after January 1, 2014, and before January 1, 2021.

The FTB had originally estimated that $22 million in credits would be claimed for fiscal year 2014-15. While $15 million in credit reservations were made, taxpayers have reported $3.9 million in credits claimed on 2014 tax year returns—well short of initial program estimates. The FTB indicates the following factors may be curtailing the use of NEC credits in the short term:

- **Learning Curve:** Any new program will have procedural requirements and filing processes that are unfamiliar to taxpayers: the reservation process is new to the hiring credit area and especially small businesses may not be aware of the requirement; new programs are often associated with more frequent taxpayer return errors; and taxpayers may not be aware of the program's existence despite outreach efforts.

- **Other Credit Usage.** The enterprise zone hiring credit was targeted to be replaced in part by the NHTC credit. Taxpayers who have both credits available to claim in a tax year will tend to claim the enterprise zone credits first as they will be phased out sooner.

- **No Credit Reservation.** Not all NHTC claimants all made reservations or met other requirements and thus were not qualified to take the credit.

- **Reservations Absent Claims**. Approximately $15 million in credit was reserved in 2014, significantly more than the amount claimed. One possible reason is that some taxpayers may have unexpectedly failed to fulfill the requirement that they increase total employment over the previous year.

Staff Comments. In a mandated report to the Legislature, FTB has identified program features where changes might encourage taxpayers to utilize the program above current levels: change geographic limitations by loosening the criteria; make the eligibility requirements less restrictive; change range of qualifying wages; discontinue or streamline the credit reservation requirement expand eligibility to additional business types; increase the credit percentage from 35 percent to some higher amount; and expand education and outreach.

FTB notes in its report, and staff concurs, that any loosening of the criteria can lead to undercutting the original intent of the legislation, which was to move away from the open ended style of the enterprise zone hiring credit. The enterprise zone hiring credit was available retroactively, required no net increase in jobs, and covered all types of businesses. In approving the NCTC, the legislature was cognizant of the benefits of tests and criteria that limit the amount of revenue losses that occur when tax benefits are awarded to taxpayers which would have engaged in stipulated activities even absent the special tax treatment. The committee may want to pursue issues related to the most beneficial (and least costly) means of expanding the usage of the credit.

Staff Recommendation. Informational item.

Issue 3: California Infrastructure and Economic Development Bank—California Lending for Energy and Environmental Needs Center

Governor's Proposal. As a component of the overall cap and trade proposal, the budget requests one-time funding of $20 million from the Greenhouse Gas Reduction Fund (GGRF) to California Infrastructure and Economic Development Bank (IBank) for use in its California Lending for Energy and Environmental Needs (CLEEN) Center greenhouse gas emission reduction programs. The entire $20 million would be used for the CLEEN Center programs that fund transactions for projects that reduce greenhouse gas emissions.

Background. The GGRF, funded by the Cap-and-Trade Program, was established for the purpose of funding measures that allow California to achieve its GHG reduction goals. In addition, SB 535 (de Leon) Chapter 830, Statutes of 2012, requires that twenty-five percent of GGRF funds be spent to benefit designated disadvantaged communities, with 10 percent spent directly within disadvantaged communities.

The IBank was created in 1994 to finance public infrastructure and private development that promote a healthy climate for jobs, contribute to a strong economy, and improve the quality of life in California communities. IBank is located within GO-Biz and is governed by a five-member board of directors. IBank recently established the CLEEN Center to encourage public and private investments and will use IBank's access to capital markets for clean energy and energy efficiency projects. The CLEEN Center at IBank is designed to focus on energy-related projects for the state and local governments in California through the Statewide Energy Efficiency Program (SWEEP). The funds that support these revolving fund programs are generated by, and leveraged with, the issuance of revenue bonds in the capital markets. To support its direct loan programs, in 2014, IBank issued a bond for $95,960,000 and in 2015 issued a bond for a little over $90,000,000.

The CLEEN Center Business Plan was presented to the IBank board in February 2015 as an integral part of protecting California's environment and natural resources by offering financing that helps achieve the state's GHG goals. In its efforts, IBank anticipates working with the California Energy Commission (CEC), whose loan portfolio consists primarily of its Energy Conservation Assistance Act (ECAA) program that provides loans to school districts and local government borrowers. The ECAA loans could be pledged to serve as a credit enhancement for IBank's CLEEN bonds for municipalities and public universities, schools and hospitals (MUSH) borrowers. CLEEN bonds also would be secured by new IBank clean energy financings, including energy efficiency financings to MUSH Borrowers. IBank would pledge the 2005A CEC Pledged Assets (CEC Portfolio) and the additional unpledged ECCA loans to the CLEEN bonds. CLEEN bond proceeds also could be used by IBank to fund larger and more complex clean energy projects for MUSH borrowers than existing programs

Staff Comments. The proposal is a part of the Governor’s cap and trade plan, most of which will be discussed in Senate Budget Subcommittee No. 2. Given that the discussions of the plan are still in process, action on this issue would be premature, and the issue can be taken up by the committee at a later date.

Staff Recommendation. Hold open.

Vote.

Issue 4: California Infrastructure and Economic Development Bank—Administrative Workload

Governor’s Proposal. The Governor's Office of Business and Economic Development (GO-Biz) requests increased reimbursement and corresponding expenditure authority from the California Infrastructure and Economic Development Bank Fund in the amount of $1.5 million in 2016-17 ($1.3 million in 2017-18 and ongoing). The new funding will allow the California Infrastructure and Economic Development Bank (IBank) to administer the Small Business Finance Center, bond programs, and loan programs. To ensure appropriate implementation and administration of the numerous existing, new, and expanding programs, IBank also requests the establishment of 11 permanent positions. The positions include staff programmer analysts, assistant trainee, associate government program analyst, attorney, senior loan officer and six staff loan officers.

Background. The IBank has broad authority to issue tax-exempt and taxable bonds, provide financing to public agencies, provide credit enhancements, acquire or lease facilities, and leverage state and federal funds. The IBank's current major programs include:

- **Direct Loan Unit.** This unit includes the Infrastructure State Revolving Fund (ISRF), providing low-cost financing to public agencies for a wide variety of infrastructure projects; Statewide Energy Efficiency Program (SWEEP), which provides low-cost financing to state and local governments for approved energy efficiency projects; and, California Lending for Energy and Environmental Needs (CLEEN) Center which encourages public and private investments.

- **Bond Unit.** This unit includes: 501(c)(3) Revenue Bond Program which provides tax-exempt financing to eligible nonprofit public benefit corporations for the acquisition and/or improvement of facilities and capital assets; Industrial Development Revenue Bond (IDBs) Program providing tax-exempt financing for qualified manufacturing and processing companies for the construction or acquisition of facilities and equipment; Exempt Facility Revenue Bond Program which provides tax-exempt financing for projects that are government-owned or consist of private improvements within publicly-owned facilities; and Governmental Bond Program which provides bond financing to provide financial support for various state entities and programs.

- **Small Business Finance Center.** The Small Business Finance Center has subcategories of programs including the State Small Business Loan Guarantee Program, the Export Financing Program, the Farm Loan Program, and the Disaster Relief for Small Business Program. These programs provide repayment guarantees to lenders for loans to small businesses experiencing difficulty securing financing on their own.

- **Additional Units.** The IBank also includes the Compliance Unit, Fiscal Unit, Legal and Legislative Unit and Technical Resource Support Center.

Staff Comments. The department has provided reasonable measures of workload increases and the requirements for additional staff. The proposal indicates that the additional resources will be sufficient to work down the existing backlog. If this occurs, then once the backlog is reduced, there would excess staff capacity, absent a steady increased demand for services. The extent to which these separate workloads mesh should be addressed by the department and the item held open pending receipt of this information.

Staff Recommendation: Hold open.

Vote.

Issue 5: Governor’s Office of Business and Economic Development—Administrative Workload

Governor’s Proposal. The budget includes a request for additional administrative resources for the Governor's Office of Business and Economic Development (GO-Biz). Specifically, The Governor requests ongoing budget authority for four positions and $309,000 in General Fund to provide administrative support services to the Human Resources, Business Services, Contracts and Procurement units. This proposal will provide funding for three positions (GO-Biz will absorb the cost of one position). The requested positions are: one staff services manager I (SSM

I) position and one management services technician for the Business Service Unit, and one staff services manager (SSM I) and one staff services analyst (SSA) for the Human Resources Unit.

Background. GO-Biz staffing issues have been addressed in previous Fiscal Integrity and State Manager's Accountability Act audits. In its most recent report, GO-Biz was noted for a lack of separation of duties, policies and procedures and adequate coverage for its administrative support functions. The department indicates that due to many of the programs within GO-Biz growing, additional resources are needed to support the additional workload being created in the areas of human resources, business services, contracts and procurement.

GO-Biz received four additional administrative support positions in 2014-15, but the department has expanded in terms of responsibilities and workload since that time. Four additional positions are being requested to provide additional support in the Human Resources, Business Services, Contracts and Procurement units. The contracting and procurement needs of the department have increased with the California Competes program, the Capital Infusion Grant Program, the changing needs of the infrastructure and Economic Development Bank and the Film Commission. The human resource needs of the department have also increased with new positions and program expansions. With the new positions and program expansions, no additional human resource staff was added. The current staffing consists of one senior personnel specialist received in a 2014-15 BCP, one redirected associate personnel analyst and the administrative manager. No new funding was received for the senior personnel specialist. The funds were redirected from the various programs within GO-Biz.

Staff Comments. Due to its growth and absorption of other activities, GO-Biz is somewhat administratively understaffed. Currently, GO-Biz has seven full-time administrative positions to cover information technology, human resources, facilities, business services, procurement, contracts, and budgets for the department of 98 authorized positions and seven temporary help positions. GO-Biz indicates the increased staffing will eliminate the backlog of work within the Human Resources Unit and the Business Services Unit. The additional assistance to the various programs within GO-Biz will go towards eliminate delays in response time to executive staff, managers, supervisors and control agencies.

Staff Recommendation. Approve as budgeted.

Vote.

CALIFORNIA CREDIT AND DEBT OVERVIEW

Presenter: State Treasurer's Office
Public Finance Division

General Obligation Bonds and Debt Service. Expenditure of bond proceeds is reflected in the budgets of individual departments, with the payment of bond debt service 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 source. The Economic Recovery Bonds (ERBs), which were self-financed, received a quarter-cent of the sales tax as a component of the 'triple flip' enacted as part of the 2004 budget package. The ERBs have now been paid off, and sales tax resources dedicated to General Fund bond repayment are now flowing to local governments and the property tax backfill shifted back to K-14 education.

The Governor's budget includes $4.9 billion in General Fund costs for General Obligation (GO) bond debt service and related costs. In addition, about $1.2 billion in debt costs are scheduled to be funded from special funds. Finally, federal bond subsidies, through the Build America Bonds (BABs) program, will provide $326 million in 2016-17, allowing for a reduction in General Fund expenses. The Governor's proposed budget includes about $126 billion in General Fund available for debt service (including carry-over balances but excluding amounts to be transferred to the BSA). The net General Fun debt service for GO bonds as a percentage of General Fund resources is approximately four percent.

Governor's Budget for General Obligation Bond Debt
(Dollars in Millions)

Category	2014-15 Actual Cost	2015-16 Estimated Cost	2016-17 Forecasted Cost
General Fund Cost[1]	$4,737	$4,870	$4,913
Other Funds Cost	941	1,133	1,244
Federal Subsidy (Build America Bonds)	326	326	326
Total Debt Service	**$6,004**	**$6,329**	**$6,483**

[1] Includes variable rate bond and commercial paper expenses.

Debt service is expected to creep up in the budget year due to recent past bond sales and anticipated issuances. The State Treasurer's Office (STO) plan includes an assumption that $3.3 billion in General Obligation bonds will be sold (or have been sold) in 2015-16, and that $4.0 billion will be sold in 2016-17. In addition, the STO assumes that $6.6 billion in bonds will be retired over the same period. In recent years, the state's GO Bond debt service cost per borrowed dollar has generally declined. This has occurred not only because of the general decline in interest rates, but also the state's improved credit rating. In 2010, the spread between California's 30-year borrowing costs was 150 basis points (1.5 percent) higher than term-comparable AAA rated paper; while the current spread is closer to 25 basis points. The STO has taken advantage of this dynamic and maintained an active refinancing program.

Budget and Bonds. Paying GO bond debt is a significant General Fund expense. State and federal tax exemptions for interest income received by investors ensure that GO bond debt is a low-cost financing alternative. To the extent bond costs do not exceed a government's long-term ability to fund other commitments, bonds typically allow the public to enjoy the benefits of infrastructure investment more quickly than would otherwise be the case. The LAO indicates that the state's gross debt service requirements for infrastructure for bonds already sold will remain around six percent of General Fund revenues over the next several years, and cost roughly $6 billion annually over the same time period. (This does not include the full costs of Proposition 1 water bond sales, which are slated to occur over a number of years.)

Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. During difficult budget times, such as the recent great recession, bonds enable the state to invest in infrastructure while the need for economic stimulus is most acute, borrowing costs are low, and construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. Assuming that a bond carries an interest rate of five percent, the cost of paying it off with level payments over 30 years is close to $2 for each dollar borrowed—$1 for repaying the amount borrowed and close to $1 for interest. This cost, however, spread over a 30-year period, after adjusting for inflation is considerably less—about $1.30 for each $1 borrowed. The Legislature can increase or limit bond funding through the budget process as overall expenditures are prioritized.

Despite the interest costs associated with debt, the decision to issue bonds comes with numerous advantages, as outlined above. In addition to these benefits, the current interest rate environment, which continues to display very low long-term rates, presents unique advantages for the issuance of long-term debt for the state. For AA rated twenty-year paper, the average yield continues to be under three percent.[2] These low rates have persisted, despite the relatively strong US economy which would ordinarily place upward pressure on interest rates.

The Administration proposes maintaining its current market level of bond issuance and to pay for substantial capital improvement through cash outlays. While this is not an unreasonable use of cash, an alternative process to consider would involve borrowing during the current, low-interest rate environment and retaining the cash for use during a future period when higher interest rates prevail.

Bond Management. When the state's cash situation deteriorated during the 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 occurring slower than anticipated at the time of bond sales, large bond cash balances developed—about $9.7 billion as of December 2011. As a result, the Administration implemented a plan to utilize commercial paper to aid cash flow, thus reducing the need to carry large bond cash balances. As part of this effort, the Administration requires GO bond programs to demonstrate an immediate need for additional bond proceeds

[2] California's current long-term General Obligation bond ratings from the three major services are: Moody's-Aa3; Standard & Poor's-AA-; Fitch-A+.

prior to issuing new bonds. Progress has been made to reduce bond cash, and cash reserves have dropped to just under $1.4 billion by the end of December 2015. At budget hearings, the Administration could be asked to discuss their management of bond proceeds, forecasts of project expenditures, and the optimal level of cash balances.

Staff Recommendation: Informational issue.

0950 STATE TREASURER'S OFFICE

Department Overview. The State Treasurer's Office (STO), a constitutionally-established office, provides banking services for state government with goals to minimize interest and service costs and to maximize yield on investments. The Treasurer is responsible for the custody of all monies and securities belonging to or held in trust by the state; investment of temporarily idle state monies; administration of the sale of state bonds, their redemption and interest payments; and payment of warrants or checks drawn by the State Controller and other state agencies. In addition, the Treasurer sits on numerous boards and commissions that deal with state, programs, investments and financing.

Budget Overview. The STO receives the great majority of its funding—roughly 75 percent—from reimbursements. The General Fund contribution to the office is roughly 14 percent of the total. As shown in the table below, position authority has remained relatively stable.

State Treasurer's Office
Program Expenditure
(dollars in thousands)

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Investment Services	$3,644	$3,481	$3,489
Centralized Treasury & Securities Management	12,644	13,528	13,731
Public Finance	9,949	11,251	9,874
Administration	13,967	15,770	15,728
Distributed Administration	-11,079	-9,965	-9,926
Total Expenditures	**$29,125**	**$34,095**	**$32,896**

State Treasurer's Office
Position Authority
(actual positions)

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Investment Services	13.0	18.0	18.0
Centralized Treasury & Securities Management	62.5	63.5	65.5
Public Finance	56.1	53.3	50.3
Administration	84.9	90.9	92.9
Total Positions	**216.5**	**225.7**	**226.7**

Issue 1: Debt Management System

Presenter: State Treasurer's Office

Background. Last year the State Treasurer's Office (STO) received continued funding for the replacement of the departments' debt management system. The $1.4 million (reimbursements) consisted of $302,000 for a project management support vendor, $200,000 for Department of Technology (CalTech) procurement assistance, $97,000 for the procurement assistance vendor, $140,000 for independent verification and validation services, $113,000 for CalTech project oversight, and $530,000 of continued funding for positions (data processing manager, senior programmer analyst, system software specialist, and treasury program manager.

In conjunction with this funding, the STO changed the procurement strategy for the DMS II Project from what was as previously submitted in SPR1, based on vendor feedback provided to the STO from the pre-solicitation RFP and resulting analysis. Subsequent to the submission of the May Revision request, staff was notified of requested change in the procurement strategy. In 2013, the STO had determined that replacing the existing debt management system with a solution-based procurement using a systems integrator was in the state's best interest, due to available expertise staffing. However, STO subsequently determined, based on potential vendor feedback, that it would be very difficult to completely satisfy business requirements at an acceptable cost and/or within a reasonable timeframe. Following more in depth vendor conversations, STO explored alternative procurement strategies and models and determined the debt management system replacement could be better addressed by using the existing debt management system and expert-level technicians rather than STO staff. CalTech agreed with this decision. The STO's funding request of $1.4 million remains unchanged.

The STO received funding for this project in 2013-14 and 2014-15. The new system is necessary for debt administration, including duties associated with trustee, registrar and paying agent responsibilities, payment of debt service, disclosure and analysis of debt issuances. Given the increased legal and financial complexities in the debt markets, the STO indicates a need for a new system to administer outstanding debt, track and pay debt service and fees on outstanding debt, and track and validate the issuance of new debt. The existing system dates to 2004.

Staff Comments. The debt management system is an essential component for the STO to follow-through on its essential services. The STO has adjusted its procurement plan in response to concerns raised through the interested parties' process, as well as a result of concerns voiced by the Legislature, including this committee. The efforts of the STO's Debt Management System should continue to be monitored by the committee in order to help ensure that the project is delivered in a satisfactory manner.

State Recommendation. Informational issue.

0968 CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

Issue 1: Compliance Monitoring Staff Augmentation

Governor's Proposal. The proposed budget includes a request for four permanent full-time associate government program analyst (AGPA) permanent full-time positions in the compliance section of the California Tax Credit Allocation Committee (TCAC). The additional positions would perform Internal Revenue Service (IRS) Code compliance monitoring services for the current inventory of affordable rental housing. TCAC indicates that its current staffing levels are insufficient to carry out the compliance monitoring mandated by Federal Internal Revenue Code (IRC). The requested resources are to be funded by special funds. The state Health and Safety Code, Section 50199.9(d), allows TCAC to establish and collect fees for the purpose of paying the costs of monitoring projects with allocations of tax credits for compliance with federal and state law.

Background. TCAC administers both federal and state low-income housing tax credit programs. Both programs encourage private investment in rental housing development for low and very low-income families and individuals. Congress created the federal Low-Income Housing Tax Credit (LIHTC) as part of the 1986 Tax Reform Act, and it was made permanent in 1993. The program helps private developers/owners create and preserve affordable housing and raises project equity through the sale of tax benefits to investors who hold an ownership interest in the property. The LIHTC Program has become the primary funding source for developing affordable rental housing throughout the country. State housing tax credits, authorized in 1987, provide further investor tax benefits, as well as supplement the federal tax credit.

TCAC has helped fund the construction of over 272,630 total units since its inception, including more than 10,000 last year. Developers rely on federal, state, and local funding sources to build affordable housing as evidenced by the receipt of over 300 applications annually. To assure federal compliance and properly maintained properties, TCAC must perform federally-mandated compliance monitoring functions. In 1992, Congress amended the IRC to include a provision specifying that a state's plan for allocating credit will not be deemed qualified unless it contains a procedure that the state will follow in monitoring compliance with the code's provisions.

Regulations require that the states conduct physical inspections of each property every three years and also imposed a more rigorous physical inspection standard than formerly. Property inspections must include a physical inspection of all building exteriors and common spaces, and physical inspections of at least 20 percent of the units in each of the properties. TCAC must also review at least 20 percent of the tenant files for income and rent eligibility. Additionally, an initial inspection of all projects is required to be completed by the end of the second calendar year following the year that the last building is placed in service.

TCAC contracted with an outside consulting firm in 2007 to produce a workload analysis of all compliance functions and staffing requirements. The study concluded that TCAC would needed one additional manager and two staff positions in 2008, with an additional staff person needed each year going forward. Additional demands for inspection occurred in 2008, when the federal

Housing and Economic Recovery Act of 2008 (HERA), included changes that affected the recertification requirements for properties, determined that rents and income requirements would be treated differently, added additional student verification requirements, and created an entirely new program requirement in the collection of tenant demographic data. Also in 2008, the IRS released updated utility allowance regulations which implemented new protocols for all monitoring agencies to verify sub-metering and energy efficiency standards at properties in their portfolio. Finally, In January of 2009, President Obama enacted the American Recovery Re-investment Act, which created two new programs to be monitored by TCAC—the Tax Credit Exchange Program (TCAP) and Section 1602 Funding.

TCAC's property portfolio currently contains over 3,300 active properties (excluding 507 in the preliminary reservation stage), with over 272,630 tax credit units statewide, resulting in housing over 517,000 tenants in tax credit properties. Of these, 2,475 properties have received an allocation of tax credits within the last fifteen years and 905 are in the extended use portfolio (after year 15). With increased portfolios, the amount of monitoring continues to increase. Currently, TCAC adds about 220-240 projects per year, which constitutes a 6.27 percent growth rate in the portfolio yearly. The department's re-syndication activates and pilot programs impose additional demands on staff. Current workload projections show that in calendar year 2015, TCAC has a deficit of 4.19 PY's. This deficit will grow over time as the department's portfolio grows.

Staff Comments. Staff has no concerns with this proposal. The compliance activities conducted by the department are essential to the integrity of the program and federally-mandated. The department has amply demonstrated additional resource needs through its workload analysis.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 2: Development Section Staff Augmentation

Governor's Proposal. The budget includes a request for three associate governmental program analyst (AGPA) positions for the development section of the California Tax Credit Allocation Committee (TCAC). These positions would to carry out core functions and administer federal and state mandates of the Low-Income Housing Tax Credit (LIHTC) program. This request will not impact the General Fund, and would be funded out of program fees established by the department to pay necessary administrative costs.

Background. TCAC is responsible for administering the allocation of federal and state low-income housing tax credits (LIHTCs) for the development of low-income housing. The amount of federal LIHTCs allocated by the Internal Revenue Service (IRS) is based on the product of a per capita factor and the state's population. Annual increases in the per capita factor and state population continues to increase the amount of annual federal LIHTCs from $63.8 million in 2004 to $89.3 million in 2015 (40 percent increase) available for allocation to develop low income housing projects. In addition, available state tax credits have continued to increase—from approximately $74 million in 2004 to $93.8 million in 2015 (27 percent increase).

Applications for the program are reviewed by TCAC staff. Continuing changes to the project requirements, such as sustainability and accessibility, has resulted in more complex reviews and additional technical assistance from staff. TCAC is required by federal law to conduct three reviews of the applications through the entire development process. Due to the increase in the volume and complexity of applications, workload has increased at each stage of the reviews significantly. Specifically, the review of applications at the placed in service (PIS) stage has a large backlog due to the increased number of applications and the added complexity due to project requirements. The PIS review culminates in the issuance of the IRS tax forms to the developer and the investor. The timely issuance of the tax forms is critical for investors to filing tax returns and claiming the tax credits for that year. Adverse impacts of the backlog and delay of the tax forms can result in amended tax returns, increased fees, and delayed equity pay-in schedules that are not being met. Subsequent federally-required subsequent reviews assure the state that the project development is moving along as anticipated. The increased application volume creates an amplified workload for Development Section staff. With the current staff levels, TCAC risks missing federally-mandated reviews.

As the state allocating agency, TCAC must respond to changes that occur in the LIHTC program. An example of changes are cost monitoring and study to keep project costs down, and modifications to the competitive scoring due to the diminished public resources availability. The increased workload associated with ongoing changes and issues include different forms of data analyses, surveying project data, and stakeholder consultation. TCAC is responsible for providing data annually, in the form of increasingly detailed and extensive surveys, to the Department of Housing and Urban Development (HUD) and the National Council of State Housing Agencies (NCSHA).

There have also been a number of other expansions of TCAC responsibilities, including:

- The number of existing TCAC projects re-syndicating and applying for new credits has increased over 100 percent since 2011. Re-syndications require additional review both at the initial stage as well as the final stage, which requires additional staff time and is accounted for in the workload analysis chart.

- In 2014, TCAC added a new apportionment within the rural set-aside, titled the Native American apportionment, for applications proposing projects on an Indian reservation, whether the land is owned in fee or in trust. There have been challenges associated with the new apportionment that has resulted in more staff time research and technical assistance relating to development on these sites.

- In 2010, federal regulations permitted housing credit agencies to conduct subsidy layering reviews while following the same guidelines as HUD. This policy change accompanied federal policy to more readily provide federal funding along with tax credits. TCAC now performs subsidy layering reviews because HUD could not complete the reviews and enable

TCAC to meet required federal deadlines. TCAC has been conducting these reviews since 2010.

- In 2013, HUD launched its Rental Assistance Demonstration (RAD) to preserve and enhance affordable units by allowing public and assisted housing to convert to more stable funding. The introduction of RAD has increased the number of projects requiring subsidy layering reviews as well as added more complexity to the reviews. In 2014, the number of complex subsidy layering reviews increased to more than 50 annually.

- In 2011 federal legislation made significant changes to the Section 811 program. The primary purpose of this program is to use LIHTCs to provide housing for extremely low-income persons with disabilities while also making available appropriate support and services. This demonstration program continues to involve TCAC, along with other state agencies, administering the allocation of additional resources resulting in additional workload. This also signals a federal trend toward greater reliance upon tax credits to develop special needs housing.

- In 2015, the STO emphasized the increase in production of affordable units by utilizing noncompetitive four percent federal low-income housing tax credits. TCAC conducted listening sessions with the stakeholder community to discuss possible changes to the regulations to promote the increase in applications. In July, TCAC proposed regulations changes that is expected to increase the number of applications requesting noncompetitive four percent federal low-income housing tax credits.

Staff Comments. The department indicates that TCAC Development Section staff worked over 400 overtime hours in the last fiscal year and is on track for a similar pattern for this fiscal year. With the ongoing increase in the workload, there has been one additional position increase for the Development Section of TCAC in at least the last 10 years. TCAC has explored other options to eliminate the backlog, which includes re-evaluating the review process, streamlining submittal requirements, and updating checklists. The department has provided a reasonable case of the need for additional resources

Staff Recommendation. Approve as budgeted.

Vote.