



MAJOR ISSUES (February 1994)

%Consolidate the State's Housing Agencies. The state's current division of housing programs among three agencies is fragmented, uncoordinated and inefficient. The administration proposes to consolidate two of the housing agencies. We recommend consolidating all three agencies. (See page G-11.)

%High Costs of Administering HCD's Bond-Funded Program. The HCD expenditures to administer the housing bond programs are exceedingly high. Our review indicates that the HCD will spend over the course of a few decades 50 cents to administer each dollar of housing loans it provides. We offer a series of options for legislative consideration. (See page G-23.)

%Legislature Needs Restructuring Plan for the Department of Insurance, Conservation and Liquidation Division. Our review of the division indicates that significant management and organizational issues need to be addressed before the Legislature approves the division's budget. (See page G-43.)

%Legislature Needs Information on the Effectiveness of Defense Conversion Matching Grant Program. The overarching goal of defense conversion is to retain or create jobs by reallocating resources from defense-related projects to other uses. We recommend that the agency provide information to the Legislature as to how this program will enhance the state's effort to maximize defense conversion spending. (See page G-52.)

%Consolidate Loan Guarantee Programs. There are currently two separate small business loan guarantee programs overseen by the Trade and Commerce Agency: The California Export Finance Program and the Small Business Loan Guarantee Program. The state is not maximizing its loan guarantee authority authorized under current law. We recommend that the Legislature transfer the responsibilities of the Export Finance Program to the Small Business Loan Guarantee Program so that the state can increase the number of loans guaranteed without additional cost to the General Fund. (See page G-55.)

%Tourism Fees Should Replace General Fund Appropriations for California's Tourism Program. The state's Tourism Program is supported by the General Fund. Instead, this program should be supported by the tourism industry, as it directly benefits from the program. We recommend that the Legislature enact legislation that establishes fees for California's tourism program. These fees should replace General Fund support. (See page G-60.)

%Eliminate the Agricultural Labor Relations Board. Due to a persistent decline in workload, we recommend the Legislature eliminate the Agricultural Labor Relations Board and enact legislation transferring its remaining duties to the Public Employment Relations Board. (See page G-61.)

%Agriculture Industry Should Share Medfly Program Costs. The state has spent nearly \$46 million in General Fund revenues since 1987 attempting to eradicate the Mediterranean Fruit Fly (Medfly). We recommend that Legislature enact legislation authorizing assessment of the agricultural industry for 50 percent of the costs of the Medfly program. (See page G-73.)






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OVERVIEW

Expenditures for business and labor programs in 1994-95 are proposed to increase by 6.9 percent compared to the current year, largely due to the increased costs of implementing 1993's workers' compensation reform, increases to the state's economic development and export programs, and paying for the most recent Mediterranean Fruit Fly eradication effort.

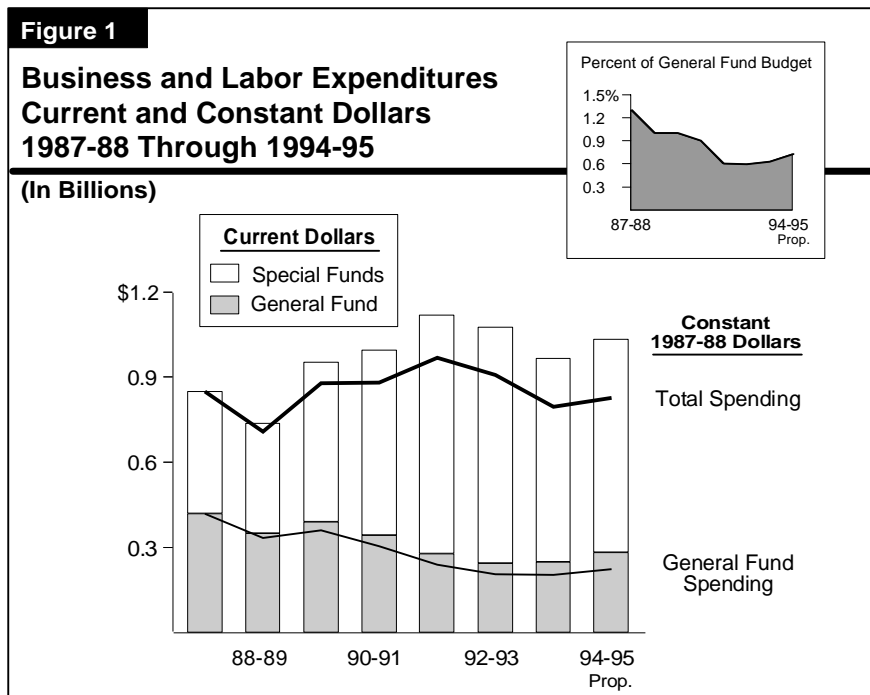
The budget proposes total state expenditures of \$1 billion for business and labor programs in 1994-95. This level of spending is an increase of \$66 million, or 6.9 percent, from estimated current-year expenditures.

Figure 1 shows that expenditures for business and labor programs from all state funds reached a peak of about \$1.1 billion in 1991-92. Over the eight-year period shown in Figure 1, expenditures increased by \$185 million, representing an average annual growth of 2.9 percent. When these expenditures are adjusted for inflation, total spending since 1987-88 has decreased by an average of 0.3 percent annually. The General Fund share of program expenditures has declined from 49 percent in 1987-88 to 27 percent in the budget year. General Fund expenditures for the budget year, however, represent a slight increase compared to the current year.

SPENDING BY MAJOR PROGRAMS

Figure 2 provides the spending trends for selected major business and labor programs from 1992-93 through 1994-95. As the figure shows, almost four-fifths of the total spending in the area is by five departments,

three supported almost entirely by special funds (Consumer Affairs, Insurance, and the Public Utilities Commission) and two supported by a mixture of General Fund and special funds (Industrial Relations and Food and Agriculture).



General Fund Increases. While the dollar amounts are low, several business and labor departments received large percentage increases in General Fund support. For example, Corporations will increase its General Fund expenditures by 107 percent in 1994-95. Other examples include Housing and Community Development, which received a General Fund increase of 35 percent, and Trade and Commerce and Industrial Relations, which received a 10 percent and 12 percent increase respectively.

MAJOR BUDGET CHANGES

Figure 3 summarizes major budget changes proposed for business and labor programs. As shown in the figure, there are large increases

Figure 2					
Business and Labor Budget Summary					
Selected Program Funding					
1992-93 Through 1994-95					
(Dollars in Millions)					
Programs	Actual 1992-93	Estimated 1993-94	Proposed 1994-95	Change From 1993-94	
				Amount	Percent
Consumer Affairs					
General Fund	—	—	\$1.1	\$1.1	—
Special funds	\$198.4	\$222.3	228.8	6.5	2.9%
Totals	\$198.4	\$222.3	\$229.9	\$7.6	3.4%
Alcoholic Beverage Control					
General Fund	\$3.6	—	—	—	—
Special funds	17.2	\$24.5	\$27.0	\$2.5	10.2%
Totals	\$20.8	\$24.5	\$27.0	\$2.5	10.2%
Corporations					
General Fund	—	\$1.5	\$3.1	\$1.6	106.7%
Special funds	\$24.8	28.7	30.6	1.9	6.6
Totals	\$24.8	\$30.2	\$33.7	\$3.5	11.6%
Housing & Community					
Development					
General Fund	\$21.6	\$8.5	\$11.5	\$3.0	35.3%
Special funds	5.9	5.8	6.0	0.2	3.4
Totals	\$27.5	\$14.3	\$17.5	\$3.2	22.4%
Trade and Commerce					
General Fund	\$25.8	\$35.5	\$39.2	\$3.7	10.4%
Special funds	9.1	4.3	4.6	0.3	7.0
Totals	\$34.9	\$39.8	\$43.8	\$4.0	10.0%
Industrial Relations					
General Fund	\$117.9	\$125.2	\$140.5	\$15.3	12.2%
Special funds	25.4	34.9	41.1	6.2	17.8
Totals	\$143.3	\$160.1	\$181.6	\$21.5	13.4%
Food & Agriculture					
General Fund	\$60.2	\$62.6	\$69.0	\$6.4	10.2%
Special funds	107.8	112.7	118.6	5.9	5.2
Totals	\$168.0	\$175.3	\$187.6	\$12.3	7.0%
Insurance (special fund)	\$288.8	\$113.0	\$118.3	\$5.3	4.7%
Savings & Loan (special fund)	\$2.4	\$0.5	\$0.5	—	—
Agricultural Labor Relations					
Board (General Fund)	\$3.8	\$4.1	\$4.3	\$0.2	4.9%
Public Utilities Commission					
(special fund)	\$75.8	\$79.3	\$82.5	\$3.2	4.0%

Figure 3

**Business and Labor Program
Proposed Major Changes for 1994-95
General and Special Funds**

Department of Housing and Community Development	Requested \$17.5 million
	:
	Increase: \$3.2 million (+22.4%)



- \$3.4 million to repair migrant farm worker housing (General Fund)

Department of Insurance	Requested \$118.3 million
	:
	Increase: \$5.3 million (+4.7%)



- \$2.3 million to reduce automobile insurance fraud
- \$1.9 million to reduce workers' compensation insurance fraud
- \$1.5 million for increased investigation of illegal insurers

Department of Industrial Relations	Requested \$181.6 million
	:
	Increase: \$21.5 million (+13.4%)



- \$26.2 million (\$12.2 million General Fund) for implementing 1993 workers' compensation reform

Department of Trade and Commerce	Requested \$43.8 million
	:
	Increase: \$4.0 million (+7.4%)



- \$3 million to expand the Export Finance Fund for increased loan guarantees to California exporters (General Fund)
- \$1.8 million to implement a new Local Permit Streamlining Grant Program (General Fund)

Department of Food and Agriculture	Requested \$187.6 million
	:
	Increase: \$13.3 million (+7%)



- \$17 million for Mediterranean Fruit Fly eradication efforts (General Fund)

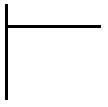
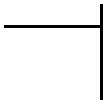
Department of Consumer Affairs	Requested \$229.9 million
	:
	Increase: \$7.6 million (+3.4%)



- \$1.1 million to transfer Athletic Commission funding from a special fund to General Fund expenditure (General Fund)

for the implementation of workers' compensation reforms, including \$26.2 million for the Department of Industrial Relations and \$1.9 million for the Department of Insurance.

The figure also shows a proposal to augment the Department of Food and Agriculture's General Fund spending by \$17 million in 1994-95 to continue Mediterranean Fruit Fly eradication efforts. In addition, Figure 3 shows a \$4.8 million General Fund augmentation for the Trade and Commerce Agency for programs to help small business through loan guarantees and local permit streamlining assistance.





CROSSCUTTING ISSUES

DOES CALIFORNIA NEED THREE HOUSING AGENCIES?

Our analysis indicates that the Governor's proposal to consolidate two of the state's housing agencies has merit, but that merging all three state housing agencies would result in even greater efficiencies and improved accountability.

BACKGROUND

California has three state housing agencies:

- Department of Housing and Community Development (HCD).
- California Housing Finance Agency (CHFA).
- Tax Credit Allocation Committee (TCAC).

Figure 4 describes the mission of the agencies and provides information on their operations.

The budget reflects implementation of the administration's legislative proposal to consolidate the TCAC within the CHFA, effective January 1, 1995.

Figure 4

Overview of California's Three Housing Agencies

Agency	Housing Assistance Programs Administered	Additional Agency Responsibilities	1993-94 Estimated State Operations Expenditures	PYs	Exempt Positions
HCD	About 20 programs. Most programs assist the development/rehabilitation of multifamily projects affordable to lower income households. Additional programs assist disaster victims, farm workers, and other groups.	State housing policy, review of local housing elements, state housing law.	\$44,107,000	703	17
CHFA	About ten programs. The largest program assists first-time home buyers. Other programs assist sponsors of multifamily projects.	Provision of mortgage insurance.	\$11,568,000	140.3	7
TCAC	One program, which assists the construction/rehabilitation of multifamily projects affordable to lower income households.	None.	\$1,663,000	13.6	1

SEPARATE HOUSING AGENCIES MAKES LITTLE SENSE

We find that the current division of state housing responsibilities between three agencies results in three major problems, as described in the sections below.

Housing Assistance Resources Are Wasted

Given the significant need for affordable housing in California, it is incumbent upon each of the state agencies to work together to ensure that affordable housing resources are allocated in the most efficient manner possible. Our review indicates that this coordination is not occurring under the current governmental system.

Instead of providing most—or all—the funds needed to construct affordable housing projects, the state's housing assistance programs typically provide only a portion of the needed revenues. In order to secure all the revenues needed for a project, therefore, sponsors of affordable housing developments frequently seek financing from more than one of the state's 31 housing assistance programs. For example, nearly 90 percent of the projects funded by the HCD's Rental Housing Construction Program also received tax credit awards by the TCAC.

Our review indicates that spreading the cost of a housing project across a number of state programs increases state agency administrative costs considerably. This is because each state agency must review the project's

application, process the financing award, and monitor the project's management for the term of the contract.

To illustrate the impact of multiple state agencies funding the same project, we show in Figure 5 the financing of two small family housing projects in Pasadena. Three state housing assistance programs—plus one state-required local housing assistance program—provided the resources for each of these projects. (While both of the projects received financing from four sources, we note that none of the funds provided by the public agencies “leveraged” other funds. That is, none of the funding commitments had the effect of making available to California more money for affordable housing than would otherwise be available for this purpose.)

Figure 5				
Financing for Two Affordable Housing Projects				
(In Thousands)				
Financial Assistance Provided				
Agency	8-unit Project	12-unit Project	Type	Program/Funding Source
HCD	\$441	\$520	Low-interest loans	Rental Housing Construction Program/ <i>state General Obligation bonds</i>
TCAC	450	524	Tax credits	Low-Income Housing Tax Credit Program/ <i>federal tax credits</i>
CHFA	188	325	Low-interest loans	Housing Assistance Trust/ <i>Investments of proceeds of CHFA bonds</i>
Local ^a	327	300	Low-interest loans	Local Low and Moderate Income Housing Fund Program/ <i>Property tax increment</i>
Totals	\$1,406	\$1,669		

^a Pasadena Redevelopment Agency

While it is difficult to estimate the administrative costs incurred in providing the financing to these small apartment complexes, we estimate that for each loan:

- HCD will spend hundreds of thousands of dollars of state housing bond proceeds to award the loan and monitor project compliance with program regulations.
- TCAC will spend more than \$10,000 reviewing and monitoring the project (all costs reimbursed by the housing sponsor)—and the housing sponsor will spend about \$20,000 in legal costs to sell the tax credits awarded by the TCAC to raise funds for the project.
- CHFA and the redevelopment agency will also spend significant sums to administer loans to the housing project. (Part of the CHFA's costs are offset by fees charged to the housing sponsor.)

Our review indicates that the total administrative costs for these projects is substantially higher than would have been the case if a single state or local housing agency provided the full funding. Our review also indicates that these high administrative costs (paid by the housing agency or housing sponsor) reduced the total resources available for construction of affordable housing.

Housing Assistance Programs Are Excessively Complicated

Housing sponsors indicate there are extensive technical and programmatic differences between the state's 31 housing assistance programs. For example, each of the state's multifamily housing assistance programs tends to have:

- Different application rules and processes.
- Different funding criteria and cycles.
- Differing maximum rent level and other restrictions.

Due to these complexities, sponsors of affordable housing projects frequently hire consultants to assist them through the maze of state programs. Our review indicates that the cost of these consultants—and the significant delays involved in coordinating assistance between the different housing programs—increases housing sponsor's costs to provide affordable housing.

Program and Fiscal Accountability Is Minimal

Finally, dividing responsibilities for housing assistance programs among three agencies makes it difficult for the Legislature or public to know which state agency to hold accountable for housing assistance programs—or to have access to important cross-program data, such as the number of non-duplicated housing units financed from state resources. We also find that the separation of housing agencies, combined with the tendency of the agencies to provide only partial financing for projects, reduces the incentive for any single agency to insist on project cost reductions, such as the elimination of subterranean parking, or to obtain waivers of the development fees that are occasionally required of affordable housing projects by local governments.

CONSOLIDATION SHOULD BE PURSUED

Our analysis indicates that similar programs tend to be administered most efficiently within a single agency. In the case of housing programs, our review indicates that a single consolidated housing agency—with strong program policy analysis capacity—would be most capable of coordinating and consolidating the multiple financing sources and providing improved fiscal and program accountability to the public, Legislature and administration.

Accordingly, we recommend that the Legislature:

- Consolidate the funding for the HCD and the TCAC within the CHFA Budget Item (2260) of the 1994-95 Budget Bill. Funds for the HCD and the TCAC would be displayed as sub-items and would be available for expenditure by the HCD and the TCAC.
- Adopt Budget Bill Language directing the CHFA, with assistance from the TCAC, HCD, Department of Finance and legislative policy committees, to prepare a new organizational plan for the housing agencies by December 1, 1994. This plan should describe how the existing functions of the housing agencies are to be carried out in the future. To the greatest extent possible, the organizational plan should group similar programs within a single division. A consolidated housing agency, for example, may need no more than four divisions, one each for multifamily housing programs, single-family housing programs, housing policy development and program analysis, and building standards.
- Enact legislation formally consolidating the housing agencies, effective no later than July 1, 1995.

- Charge the expanded CHFA with submitting a proposal for legislative consideration by July 1, 1996 for needed statutory modifications to state housing programs to improve efficiency in the delivery of the state housing assistance.

GOVERNOR'S ENERGY REORGANIZATION PLAN

Prior to budget hearings, the Department of Finance should provide written information to the Legislature on the Governor's proposal to restructure the state's energy programs. This information should detail the elements of the proposed restructuring and its anticipated effect on utility rates and the state's economy.

The Governor's Budget document indicates that the administration proposes a reorganization of state energy functions. This proposal includes elimination of the California Energy Commission (CEC) and the transfer of its functions to other government agencies (including other levels of government) and to the private sector. However, the proposed 1994-95 budgets for the Energy Commission and the other state agencies affected by the restructuring remain "status-quo." For example, although the Governor's proposal calls for elimination of the Energy Commission, the budget includes proposed expenditures of \$51.1 million from various federal and state funds for the commission in 1994-95. This is \$49.7 million, or 49 percent, less than current-year expenditures. Although this is a significant decrease in expenditures, the commission's budget is basically a "status-quo" budget because the reduction is due mainly to the end of one-time expenditures in the current year.

Background

Language in the 1993 Budget Act asked the Governor to submit to the Legislature by December 1, 1993 a plan for reorganization and reform of the Public Utilities Commission (PUC) and the Energy Commission. On December 1 the Governor sent a letter to the Speaker of the Assembly and the President Pro Tempore of the Senate proposing the elimination of the Energy Commission and the transfer of its functions to the Resources Agency, the Trade and Commerce Agency and/or the Public Utilities Commission. Additionally, the Governor proposed that some functions of the Energy Commission, such as the planning, development, and deployment of electric generation capacity in California, be left to market forces. The Governor indicated that his proposal is intended to make the state's energy policy more efficient, and therefore benefit ratepayers.

In a December 3, 1993 letter, the chairs of certain policy, energy, and fiscal committees in each house advised the Governor that the proposal lacked detail and was devoid of elements that would ensure that the objectives of California's energy policy—the promotion of lower utility rates as well as the long-term economic and environmental health of the state—are achieved. This was an accurate assessment in December and remained accurate at the time this *Analysis* was written.

Administration Should Fill in the Detail

In order for the Legislature to determine if the Governor's plan meets the Legislature's goals, objectives, and priorities for the state's energy policy, the administration must identify how the commission's current duties will be managed under the reorganization plan. Therefore we recommend that the Department of Finance provide a written report to the Legislature prior to budget hearings which, at a minimum, includes the following information:

- The priorities and goals of the administration's energy policy.
- The objectives of the Governor's restructuring plan.
- The specific duties that will be assumed by each state department, local government, and the market place.
- The potential savings and costs to the state and to utility ratepayers resulting from the restructuring plan.
- A budget for each state department that is consistent with the Governor's proposal.
- A time frame for implementing the reorganization plan.



DEPARTMENTAL ISSUES

DEPARTMENT OF CONSUMER AFFAIRS (1120—1655)

The Department of Consumer Affairs (DCA) is responsible for promoting consumerism and protecting the public from deceptive and fraudulent business practices, while supporting a fair and competitive marketplace. The department includes 27 regulatory boards, bureaus, and programs. These regulatory entities license and regulate over 2 million practitioners from various occupations and professions. Only four bureaus and one program are statutorily under the direct control of the department. The others are under the statutory control of the appointed representatives (typically, board members) of the occupations and professions they license and regulate.

The budget proposes appropriating \$229.9 million from the General Fund and various special funds for the support of the department and its constituent agencies in 1994-95. This is \$7.6 million, or 3.4 percent, more than estimated expenditures in the current year. The increase is to (1) regulate unlicensed activities among several trades, (2) improve information and complaint processing, and (3) expand investigative and enforcement activities.

Keep State Athletic Commission Funding Out of General Fund

We recommend the Legislature fund the State Athletic Commission from fee revenues available to the commission rather than from the General Fund, as proposed in the Governor's Budget. (Delete Item 1140-001-001 and add Items 1140-001-326 and 1140-001-492.)

The budget proposes spending nearly \$1.1 million to support the State Athletic Commission during 1994-95. All but \$21,000 of this amount is from the General Fund. The budget also proposes that fee revenue currently deposited into the Athletic Commission Fund and the Boxer's Neurological Examination Account and used to fund the commission instead be deposited in the General Fund.

Prior to 1992-93, the commission was funded in a manner similar to this proposal. In 1992, however, the Legislature, in response to a long series of General Fund augmentations needed to fund shortfalls between fee revenues and commission spending, created the Athletic Commission Fund. This fund, supported from fees, was to be the sole funding source for the commission, thereby eliminating the need for any General Fund support. The budget proposal would once again make the General Fund responsible for any shortfalls between commission spending and available fee revenues.

We believe that the commission, like other boards that license occupations and professions, should continue to be budgeted on a completely self-supporting basis from fee revenues. We can find no analytical basis for the commission to be subsidized by the General Fund. With the General Fund available as a backup to fund any shortfall, the commission is not required to live within its revenues as other boards must do.

In order to prevent the General Fund from subsidizing the commission, and to require the commission to be self-supporting, we recommend that the Legislature not concur with the budget request. By doing so, the commission would continue to be funded from the assessments and fees it is authorized to charge.

Legislature Needs Specific Information Before Approving Performance Budgeting

The Department of Consumer Affairs plans to have a draft performance budget plan and contract available for legislative review in May 1994. This plan should address specific issues before the Legislature approves any performance budget agreement.

The Governor proposed in his 1993-94 budget to use four departments, including the DCA, for a pilot project in "performance budgeting." For a review of the administration's proposal, please see the State Administration chapter in this *Analysis*. Despite the administration's stated intention of implementing performance budgeting in 1994-95, the budget request submitted for the DCA makes no provision for it.

The DCA Implementation Plan. The DCA, however, is in the process of completing its blueprint and planning documents with a goal of having a performance budget adopted in the budget year. To reach this goal, the DCA has established the following schedule:

- Finalize its strategic plan (mission, goals, and value statements) by January, 1994.
- Complete performance measures by February 1994.
- Conduct leadership training by April 1994.
- Adopt a management information system plan by April 1994.
- Develop a budget contract by May 1994.
- Negotiate terms of the budget contract with the Legislature by May 1994.

At the time this analysis was written, the DCA was finalizing its strategic plan and performance measures, the first two priorities in the DCA schedule. The DCA is making a commendable effort to proceed under performance budgeting, and appears to be far ahead of the other "pilot" departments. Hopefully, the remaining tasks will be completed in a timely manner and will provide the Legislature what it needs to consider implementation of performance budgeting for the DCA in 1994-95.

We recommend, however, that the Legislature not agree with a performance budget until the DCA's proposal addresses specific issues we raised in our October 1993 policy brief on performance budgeting. Specifically, the DCA proposal should address at least the following:

- The proposal should sufficiently define performance budgeting, particularly with respect to the obligations and responsibilities of the administration, Legislature, and the DCA.
 - Implementation costs and proposed funding sources should be identified.
 - The proposal should include provisions for an independent evaluation of department performance and details as to how performance will be evaluated.
-

- The proposal should identify sanctions that will be applied for poor performance and how these sanctions will be carried out.

The DCA needs to submit its proposal to the Legislature prior to budget hearings and in sufficient time to allow adequate legislative review. Once the proposal is received, we will review it and make recommendations to the Legislature as appropriate. On the other hand, if the DCA is not able to meet its timetable for producing its planning documents, or if they are not able to pass legislative scrutiny, we recommend the Legislature maintain its regular budgetary review of the DCA.

HOUSING AND COMMUNITY DEVELOPMENT (2240)

The mission of the Department of Housing and Community Development (HCD) is to help promote and provide decent housing for all Californians. As part of this mission, the department is responsible for implementing and enforcing building standards. The department also administers a variety of housing development and rehabilitation programs—and provides policy advice and statewide guidance on housing issues.

The budget proposes expenditures of \$216.5 million for 1994-95. This is \$69.8 million, or 24 percent, less than estimated current-year expenditures. Most of this decrease reflects reduced estimates of local assistance to be provided under the Century Freeway Program (-\$33.4 million), the California Disaster Assistance Program (-\$16.6 million), and various federal programs (-\$11.8 million).

In this *Analysis*, we review the HCD's bond-funded, disaster assistance, and Office of Migrant Services (OMS) programs. We then provide an in-depth review of the state's Employee Housing Program.

HIGH COSTS TO ADMINISTER HCD'S BOND-FUNDED PROGRAMS

The cost of administering the HCD's housing bond program is exceedingly high. We recommend that the Legislature consider alternative methods of providing housing assistance in the future.

Over the last several years, the Legislature has expressed significant concerns regarding the mounting costs of the HCD to administer three recent housing bond measures: the Earthquake Safety and Housing Rehabilitation Bond Act of 1988 (Proposition 77) and the Housing and Homeless Bond Acts of 1988 and 1990 (Propositions 84 and 107). Figure 6 provides information about the programs funded through these bond programs.

In order to explore this concern in greater detail, the Legislature directed the department in 1990 to develop an estimate of its long-term costs for administration of these bond programs. On January 18 of this

Figure 6	
Department of Housing and Community Development Overview of Housing Bond Programs Authorized by Propositions 77, 84, and 107	
(In Millions)	
Program/Purpose	Total Bonds Authorized
Rental Housing Construction Program	
Construction of multifamily housing	\$300
California Housing Rehabilitation Program	
Health and safety rehabilitation of multifamily and owner occupied housing	117 ^a
Seismic and health and safety rehabilitation of multifamily housing	33 ^a
Acquisition and rehabilitation of residential hotels	40
Family Housing Demonstration Program	
Construction of family housing	15
Emergency Shelter Program	
Construction and rehabilitation of emergency shelters	35
Office of Migrant Services	
Construction and rehabilitation of migrant farm worker centers	10
Total	\$550

^a Proposition 77 authorized a total of \$150 million for the CHRP. Of this amount, \$80 million was to be used for seismic repairs and \$70 million for health and safety rehabilitation. Because the HCD received few applications for seismic renovation funds, the Director of the HCD transferred \$47 million of the funds for seismic renovation to the funds for health and safety rehabilitation. Figure 1 shows the *revised* amounts provided for these programs.

year, the department finally submitted its long-term cost estimates for three of the largest bond-funded programs. These include the:

- Rental Housing Construction Program (RHCP).
- California Housing Rehabilitation Program (CHRP).
- Family Housing Demonstration Program (FHDP).

In submitting the long-awaited cost estimates, the department indicated that the estimates represent the current management plan of the administration, but that the department will attempt to explore ways to reduce these costs in the future.

Initial Review of the Department's Findings

While the late release of the department's report did not afford us sufficient time to review the document in detail, we discuss below several major findings.

Housing Bond Program Administrative Costs Are Extraordinarily High. The department's report shows that the HCD will have spent \$30 million to administer the RHCP, FHDP, and CHRP through the end of the budget year—and that the department will spend about \$200 million to administer these programs for the term of the regulatory agreements (generally 25 to 50 years). In short, the department expects to spend nearly 50 cents—over the course of a few decades—to administer each dollar it provides in housing loans.

Measured on a per Project Basis, Administrative Costs Are Staggering. Our review indicates that by the end of the budget year, the HCD will have spent about \$100,000 *per project* in administrative costs under the RHCP, FHDP, and CHRP multi-family programs. Moreover, by the end of the loan term, the HCD will have spent about \$700,000 *per project* in administrative costs. Our review indicates that these costs are exceptionally high relative to the number of housing units assisted. The median number of housing units assisted by an RHCP loan, for example, is only 24.

We also reviewed these administrative costs estimates relative to the amounts loaned on RHCP and FHDP projects (we do not have comparable data for the CHRP program). Our review found that, in many cases, administrative costs are very high in relation to the amounts loaned. For example, we found that long-term project administrative costs *will exceed* the project loan amounts for one out of every six RHCP and FHDP projects. That is, the state will spend more money for administrative costs than it provides in loans.

Administrative Costs Will Vastly Exceed Reserves. Administrative costs for these bond programs are paid from the bond proceeds, rather than the General Fund. In order to ensure sufficient funds for this purpose, the department reserved a total of \$59.3 million of the \$550 million in authorized bonds and allocated this amount among a series of program-specific administrative reserves. The use of the bond proceeds for this purpose is permissible under the bond acts.

Due to high costs of the bond program, two small bond programs have already depleted their administrative reserves. (The Emergency Shelter Program's administrative costs are now paid by the General Fund, and the CHRP *single* family program's costs are being paid by the CHRP *multifamily* program.) Moreover, by the end of the loan terms, the HCD estimates that its administrative costs for all of the programs will exceed

the funds it reserved for this purpose—by a factor of three-and-a-half times.

Reasons the Housing Bond Programs Cost So Much

Our review indicates that three issues related to program design—combined with ineffective management at the HCD—are primarily responsible for the extraordinary costs of housing bond program administration. We discuss the issues related to program design below.

Long-term Monitoring Requirement. First, the bond acts require that the housing financed with their proceeds be reserved for low-income and very-low income households for long periods of time. In the case of the RHCP, for example, most of the projects will be reserved for low-income households for 50 years. The HCD indicates that it must monitor the projects for this entire period to ensure compliance with the regulatory agreements and to protect the state's investment. The HCD estimates that each project takes approximately 62 to 72 direct staff hours to monitor each year. Thus, long-term affordability requirements will result in significant state costs.

Maximum Leveraging Requirement. Second, the bond acts require the HCD to allocate bond proceeds in a manner which maximizes the use of private, local, and other funding sources. While this leveraging requirement was intended to increase the number of housing projects which could be assisted, the requirement has serious implications for HCD administrative costs. Spreading the same amount of bond funds over a larger number of projects means that the HCD must review many more applications, close more loans, and monitor more projects than it would otherwise. Extensive leveraging also means that each project's financing is much more complicated and costly for the HCD to review.

To illustrate the impact of leveraging upon the HCD's administrative costs, consider the following example: a nonprofit housing sponsor proposed to build six units of family housing in Menlo Park. Rather than providing the majority of the financing for these units, the HCD provided a \$240,000 loan and financed *two* units. (The rest of the financing for the project came from the federal Low-Income Housing Tax Credit program—\$466,000, the federal Community Development Block Grant program—\$190,000, and private loans—\$150,000.) We note that although the HCD lent only \$240,000 to the project sponsor, the HCD's cost to review the application, close the loan, and make annual visits to the project for monitoring purposes does not appear to be significantly less than projects where the HCD lent much greater sums. In addition, we note that although the housing project received financing from three state and federal sources, none of the funding commitments actually

“leveraged” other funds. That is, none of the funding commitments had the effect of making available to California more public funds for affordable housing than would otherwise be available for this purpose.

Specialized Programs. Third, the bond measures divided the \$550 million in bond proceeds among *six different* HCD programs—and further specified that 20 percent of the bond funds for each program be set-aside for projects in rural areas. Our review indicates that subdividing the bond proceeds in this fashion increases administrative costs, because each of the six programs tends to need its own specialized staff, managers, regulations, and loan application and review processes.

Options for Legislative Consideration

Below, we present a series of options for legislative consideration. These options include actions which the department may take to reduce the cost of the *current* bond-funded housing programs, options for the design of *future* housing programs—and options for *restructuring* our state-local governmental system for providing housing assistance to needy Californians.

Ways to Reduce Cost of the Current Housing Bond Program. If HCD continues to administer the housing bond programs in accordance with its current management plan, the housing bond programs eventually will become a significant General Fund liability and/or housing project loan repayments will be diverted to pay administrative costs rather than be lent again to support the construction of affordable housing. Accordingly, it is imperative that the HCD develop options to reduce the cost of its current management plan.

Because most of the housing loans have been awarded already and relatively few new loans will be awarded in the coming years, our review indicates that the HCD should focus its efforts on reducing the high cost of monitoring its housing projects. We estimate that the current HCD monitoring plan costs roughly \$4,000 per multi-family project each year. This cost includes two separate on-site visits per year (one by a program staff representative and one by a construction inspector) for up to 50 years.

Ultimately, the purpose of the monitoring program is to ensure that: (1) housing units are rented in accordance with the program requirements, (2) housing complexes are well-maintained, and (3) the state's loans are repaid. Our review indicates that HCD should be able to meet these objectives in a less costly manner than outlined in their current management plan.

We note, for instance, that the state has two other housing agencies which also provide support for the construction of affordable housing: the

California Housing Finance Agency (CHFA) and the California Tax Credit Allocation Committee (TCAC). These agencies also require long-term monitoring of housing projects they assist. Our review indicates that housing projects frequently receive financing from two—and occasionally all three—of these state agencies. For example, nearly 90 percent of the projects funded under the RHCP also received funding under the tax credit program. It should be possible, therefore, for the HCD to enter into an agreement with the TCAC to share monitoring and inspection responsibilities and to reduce both agencies' administrative costs.

Alternatively, the HCD may be able to (1) train its staff to review the physical condition of the facilities *and* monitor program compliance, thereby reducing by half the number of required site visits, (2) contract with local private inspection companies for inspections of the physical condition of the facilities, or (3) monitor projects on a less frequent basis.

Options for the Design of Future Housing Programs. Despite some recent reductions in the cost of housing in California, the state continues to suffer from a severe shortage of housing affordable to people with low income. As the Legislature contemplates new programs to provide assistance to these households, we urge the Legislature to think broadly about different approaches.

Our review indicates that there are many ways to provide affordable housing assistance—and that a state housing bond loan program may be suitable for financing large housing projects in areas of the state with low housing vacancy rates and very high housing costs. In these parts of California, a 50-year state investment in affordable housing may be an efficient and effective way to provide housing assistance. This is because the state's administrative costs could be spread over many units and the state could be assured of an increase in the supply of housing. Even in these areas of the state, however, the current bond-funded programs could be made more efficient by (1) reducing the emphasis on leveraging other publicly provided funds, (2) consolidating the separate bond-funded programs, and (3) lowering the on-going monitoring costs, as discussed above.

In many other parts of California, our review suggests that our current housing bond program is an *inefficient* method of providing housing assistance and that it yields *fewer* units of affordable housing than would other programs funded at the same level. Accordingly, we urge the Legislature to consider alternative methods of providing housing assistance in these areas, including:

- **Housing vouchers**, or other direct subsidies to low-income households to enable them to rent moderate cost, privately provided housing.

- **Grants** to help construct housing projects financed by federal or local housing programs. Awarding grants, instead of loans, eliminates most of the state's long-term monitoring costs and reduces the state's costs to review applications and process funds. The state's interest in long-term housing affordability would be addressed by on-going federal or local housing program monitoring.
- **Private-sector contracts**, whereby the state or local agency contracts with apartment owners for the provision of housing units for low-income families. Families living in these units pay reduced rents to management for the duration of the contract.

Options for Restructuring Governmental Responsibility for Housing Programs. Finally, our review indicates that our current governmental system for providing housing assistance to low-income individuals and families has serious shortcomings which reduce the efficiency of virtually all California housing assistance programs. These shortcomings stem from a failure of our current governmental system to assign responsibility for the provision of affordable housing to any single level of government. Instead, responsibility for—and control of—the development of affordable housing is spread between three state agencies, cities and counties, redevelopment agencies, and the federal government. This division of responsibility tends to result in each governmental entity shifting costs to—and assigning blame on—the other governmental entities.

Our review indicates that virtually any housing program operating within this system is likely to have significant inefficiencies from a state-wide point of view. As a result, the Legislature may wish to consider options for *restructuring* the current governmental system to improve accountability and efficiency in the delivery of housing assistance. We outline two options below.

- **Governor's Proposal.** The budget proposes consolidating the TCAC within the CHFA. While we have certain concerns regarding this proposal (which we discuss in our review of crosscutting business and labor program issues contained in this *Analysis*), the concept of consolidating the housing agencies has merit. In fact, we believe that consolidating all *three* state housing programs would reduce state administrative costs and provide for a more efficient allocation of state resources.
 - **Making Government Make Sense.** In our *1993-94 Perspectives and Issue* (please see pages 111-132), we propose assigning local governments full responsibility for housing assistance programs. Specifically, we propose a transfer to cities and counties of all funds currently provided by the state for housing assistance. Local
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governments would have broad flexibility to structure housing programs to meet the needs of their residents, provided the outcomes of the programs meet certain performance standards. Our review indicates that this model would improve accountability and efficiency in the development of affordable housing.

COST OF NORTHRIDGE EARTHQUAKE UNKNOWN

We recommend that the department report at budget hearings on its estimate of cost to provide CALDAP loans to victims of the Northridge earthquake.

Under the California Natural Disaster Program (CALDAP), residential property owners are eligible for below-market interest rate state loans to rebuild their disaster-damaged property if they do not receive sufficient monies from insurance, private loans, or other state or federal programs. Over the last several years, the state has provided a total of \$142 million in loans under this program. The terms of the CALDAP, as revised recently by Chapter 1105, Statutes of 1993 (AB 1677, Hauser), are shown in Figure 7.

Because the Northridge earthquake occurred *after* the release of the Governor's budget, the budget does not identify funds to provide CALDAP loans to earthquake victims. Chapter 1105 requires the HCD to estimate the demand for CALDAP loans within 90 days of a disaster and request a deficiency appropriation from the Department of Finance. In order for the Legislature to have information on the cost of this housing program, we recommend that the department report at budget hearings on its estimate of demand for CALDAP loans in both the current and budget year.

Figure 7	
CALDAP Program Terms	
Eligibility	Loans are available for single-family housing and multi-family rental property.
Loan of last resort	Individuals must exhaust other state, federal, and private lender resources before they are eligible for the CALDAP.
Loan terms	<p>Primarily 30-year term for single-family loans and 20-year term for multi-family loans. Interest rates may not exceed the rate charged under the CAL-VET program (currently 8 percent), plus one-half percent for state administration.</p> <p>Payment on loans is generally deferred until loan expires or property is sold.</p>
Loan limits	\$50,000 limit per single-family home. \$35,000 per-unit limit on multi-family rental property.
Disasters covered	The program is available to victims of any disaster in which the Governor calls a state of emergency.

COSTS OF FARM WORKER CENTER REHABILITATION UNFUNDED

We recommend that the Legislature adopt Budget Bill Language directing the HCD to increase rents charged to farm workers to pay for the on-going costs of the farm worker community rehabilitation proposal.

Through the department's Office of Migrant Services (OMS), the state provides 2,166 units of low-cost housing to farm workers. These facilities are generally open from mid-spring to mid-fall, when most of the state's crops are harvested. Farm workers and their families pay rents averaging about \$4.50 per day for this housing. These rent revenues offset about thirty percent of the cost of the OMS program; the remaining costs are paid by the General Fund.

Most of the Housing Units Are in Poor Condition. Especially in recent years, housing units at the OMS centers have fallen into poor condition and many facilities have significant health and safety hazards. As we discussed in our *Analysis of the 1991-92 Budget Bill* (please see pages 223 - 226), about half of the farm worker housing units were built as temporary structures and have outlived their useful life. The rest of the housing units have deteriorated because on-going maintenance has been neglected due to insufficient funds.

Multi-year Program to Repair and Reconstruct Housing. To correct the dilapidated and unsafe housing conditions at the OMS centers, the HCD proposes a five-year, \$53 million program of housing unit reconstruction and repair. Figure 8 highlights the major components of the proposal.

Figure 8	
Office of Migrant Services Five-Year Reconstruction And Repair Proposal	
Housing Units	HCD Proposal
235	Units closed for safety reasons; replacement facilities to be constructed.
870	Repair critical health and safety hazards, and begin replacing units over a five-year period.
921	Repair all health and safety hazards and improve energy efficiency of units.
140	No repair or replacement of units necessary.
2,166	Total

The department commenced this reconstruction and repair program in the current year, using federal monies, state special funds, and \$198,000 of the department's General Fund appropriation. The cost of the remaining work in the proposed program is approximately \$39.7 million, with a total of \$5.1 million proposed from the General Fund over the next four years. Figure 9 shows the distribution of the costs of the proposed program.

Proposal Has Merit, but On-going Costs Are Ignored. If the state is to provide seasonal housing for farm workers, then the many health and safety hazards at these facilities must be abated. The department's proposal appears to be a reasonable effort in this regard.

We are concerned, however, that the proposal fails to specify how the cost of two on-going program liabilities will be paid. Specifically, the proposal does not identify a source of funds to cover: (1) the repayment of the proposed federal construction loans and (2) the necessary repair reserves to pay for maintenance of the rehabilitated farm worker communities. We estimate that these costs will total nearly \$1 million annually.

Figure 9

**Office of Migrant Service
Proposed Budget For Housing Facility
Repair and Reconstruction**

In Thousands

Year	General Fund	Special Funds^a	Federal Funds	Total
1993-94	\$198	\$5,420	\$8,450	\$13,511
1994-95	1,434	5,549	12,774	14,458
1995-96	1,690	—	8,476	10,167
1996-97	645	—	8,385	9,030
1997-98	1,367	—	4,753	6,119
Totals	\$5,334	\$10,969	\$42,838	\$53,285

^a Special funds include state bond funds.

Options and Recommendations. Our review indicates that the Legislature and administration have two major options regarding these unfunded costs. First, the Legislature and the administration could increase annual General Fund support for the OMS program. Alternatively, the HCD could raise farm worker rents at the OMS communities. (We estimate that a \$2.75 per day average rent increase would be sufficient to raise these funds. This rent increase would bring average OMS rents to \$7.25 per day, or \$220 per month.)

Given the state's current fiscal condition, and the generally modest rent levels currently charged at the OMS communities, we recommend that the Legislature adopt Budget Bill Language (BBL) directing the HCD to increase farm worker rents to cover the maximum possible portion of the \$1 million unfunded costs. We further recommend that the Legislature specify in BBL that any rent increase be subject to the following restrictions:

- Farm worker rents shall not exceed 30 percent of the farm worker household's income, or other commonly used affordability standards.
- No rent increase shall be levied for a housing unit until its repairs and/or reconstruction is complete.
- Rent increases shall not be imposed before January 1, 1995.

EMPLOYEE HOUSING PROGRAM: A RECORD OF POOR PERFORMANCE

For decades, the Legislature has expressed significant concerns over the housing conditions of agricultural workers, noting that they are “one of the worst-housed population groups in California.” In an effort to improve these housing conditions, the Legislature and the Governor have created a number of programs to assist the estimated 900,000 farm workers in the state. The two largest of these programs are the Office of Migrant Services (discussed earlier in this analysis) and the Employee Housing Program, which regulates certain privately provided housing accommodations for agricultural workers.

Reporting Mandate. Over the years, the Legislature has had many questions regarding the implementation of the employee housing program, but has not been able to examine these issues in detail, due to limited data. To address this problem, the Legislature mandated in Chapter 1031, Statutes of 1979 that the HCD submit an annual statistical report. This mandate has been broadened several times, most recently by Chapter 952, Statutes of 1993 (AB 2011, Polanco). Chapter 952 also requires the Legislative Analyst to review the HCD's statistical report and to include a summary of the data and an evaluation of the HCD's enforcement efforts in the 1994-95 *Analysis*. The following report is submitted in fulfillment of this requirement.

Employee Housing Program Background

What Is Employee Housing? The Employee Housing Act (EHA) generally applies to two types of employee housing: (1) living quarters provided for five or more employees by their employer and (2) housing accommodations in rural areas provided for five or more agricultural workers, *not* in connection with any work place.

What Are the Housing Owner's Responsibilities? The EHA requires the owner to maintain the housing in compliance with certain minimum health and safety standards, developed by the HCD, and to obtain a permit from the HCD prior to allowing the housing to be occupied.

HCD's Role in Enforcing the Employee Housing Act. Under the EHA, the HCD is responsible for:

- Annually inspecting proposed employee housing facilities, issuing permits to conforming facilities, and reinspecting nonconforming facilities.

- Locating employee housing facilities operating without permits and prosecuting serious offenders of the EHA.
- Monitoring local government enforcement of the EHA.

Local Governments May Be Delegated EHA Authority. Local governments may apply to the HCD for authority to implement the EHA in their jurisdiction. In the event of inadequate enforcement of the EHA by a local agency, the HCD may assume inspection and enforcement activities in that jurisdiction. Currently, 13 counties enforce the EHA in their jurisdictions: Fresno, Kern, Merced, Monterey, Napa, Orange, Riverside, Sacramento, San Benito, San Joaquin, San Mateo, Santa Cruz, and Stanislaus. The HCD enforces the EHA in the rest of the state *and* in most of the incorporated cities in the counties listed above.

Federal Government's Farm Worker Housing Standards. Federal law also sets forth requirements for employer-provided housing for agricultural workers. In cases where both state and federal law apply, federal law requires operators to receive permits from the HCD or the local enforcement agency.

Major Errors Plague HCD's Report to the Legislature

In fall of 1993, the HCD submitted to the Legislature its statistical report on EHA enforcement activities in calendar-year 1992. Our review indicates that the HCD's statistical report contains major errors which compromise its validity and render parts of it useless. For example, the HCD reports that there were 1,685 employee housing facilities in 1992. A careful examination of the document reveals, however, that this total includes facilities which were demolished, closed, double-counted, or never permitted. Overall, we estimate that the HCD's report overstates the number of employee housing facilities by at least 406 facilities—or by at least 24 percent.

Our review also found numerous other examples of serious data irregularities. In some cases, we note that the HCD was aware of the data weaknesses and took preliminary actions to correct them. In other cases, obvious errors were overlooked—or attributed to ambiguities in the statutory reporting requirements.

Chapter 952 requires the LAO to use the data compiled by the HCD to report summary information on the EHA program. Figure 10 summarizes the HCD information, and notes our findings as to the quality of the reported data.

Figure 10**1992 Employee Housing Program
Statistics As Reported by the HCD**

Information	HCD	Local	Total
Number of Employee Housing Facilities	706	979	1,685 ^a
Facilities found operating without a license	137	71	208 ^b
Inactive employee housing facilities	1,892	146	2,038 ^{c,d}
Number of occupants when inactive facilities last occupied	604	1,991	2,595 ^d
Number of inspections performed:			
• pre-occupancy	410	358	768
• occupancy	142	478	620
• reinspection	221	362	583
Total, all inspections	773	1,198	1,971 ^c
Number of violations found in employee housing facilities	2,048	8,972	11,020 ^d
Fees collected	\$282,622	\$200,329	\$482,951 ^b
Fines and penalties collected	\$15,030	\$9,622	\$24,652 ^b
Number of prosecutions undertaken	0	9	9 ^b
Staff time dedicated to EHA enforcement (personnel-years)	16	6.5 ^b	22.5
Personnel-years devoted to locating and prosecuting serious violators and operators of illegal facilities	.85	— ^e	.85 ^e

^a Number of facilities overstated by at least 406.
^b Quality of data unknown.
^c Significant differences in HCD and local data reporting.
^d Errors or gaps in data noted.
^e Local agencies not required to report this data.

Trends in the Stock of Employee Housing

Although the shortcomings in the data reported by the HCD greatly limited our analysis, our review did reveal three important trends in the stock of employee housing over the last decade. We confirmed these trends in discussions with state and local enforcement officials and through independent research.

Decline in the Amount of Employee Housing. Overall capacity at employee housing facilities appears to have declined substantially, perhaps by as much as a third (or housing for roughly 13,000 employees) over the last decade. Our review indicates that this decline in capacity results in part from a withdrawal from the stock of employee housing of some large facilities owned by farmers. In place of these larger facilities, the data suggests—and enforcement agency officials confirm—that there

has been an increase in the number of smaller employee housing facilities. These smaller facilities tend to be auxiliary buildings (such as converted garages) adjacent to single-family residences in rural areas and not provided in connection with work.

More Housing Reserved for Year-round Employees. While employee housing regulations and other program documents tend to refer to employee housing as *seasonal* housing, we note that in the three counties which reported data on the topic, slightly more than half of the facilities were reserved for *year-round* employees. Enforcement agency officials indicate that more housing is reserved for year-round employees than a decade ago.

Many Violations of Housing Standards. While it is impossible to determine from the data whether conditions at employee housing facilities have improved or declined over the last decade, we note that most enforcement agencies report high numbers of violations. Frequently cited violations include: broken windows, missing window screens, filth, inappropriate use of electrical extension wires, and lack of fire extinguishers. Relatively few violations posed an immediate life or safety risk.

Enforcement Agencies Not Following Law

The lack of complete and consistent data also impaired our ability to review the enforcement of employee housing law as required by Chapter 952. Despite the many weaknesses of the data, however, four serious shortcomings were evident in our review—and merit attention by the department and the Legislature.

HCD Fails to Conduct Required Inspections. Operators of 706 proposed employee housing facilities submitted fees and applications for permits to the HCD to operate employee housing facilities in calendar year 1992. Our review indicates that the HCD failed to inspect or issue permits to 130 of these facilities. In addition, our review indicates that the department failed to inspect at least another 19 proposed facilities, but issued operating permits to them contrary to state law. In total, therefore, the HCD failed to carry out its statutory inspection duties for at least one in five applications for employee housing permits in 1992. Our analysis revealed a similar record of poor performance in 1991.

Housing with Many Violations Got Operating Permits. Our review indicates that some jurisdictions issued permits to facilities with multiple violations of the EHA health and safety standards. In one extreme example, a county granted an operating permit to a facility for 24 employees which had 114 violations. The county reinspected the facility twice during the year and each time the facility had 110 or more violations. The local report indicates that the county did not revoke the employee housing permit, fine the operator, or refer the case for prosecution. Unfortunately, the lack of comparable inspection data in the HCD's report precludes us from determining how widespread this problem is among local agencies—or whether the HCD *also* issues permits to nonconforming facilities.

Local Agencies Got Only a cursory Review. While the EHA charges the HCD with conducting an annual investigation of local enforcement activities, our review indicates that this review is too short and superficial to be meaningful. In most cases, the HCD inspectors spent no more than two days on-site reviewing local enforcement efforts and providing training. In addition, the HCD did not review much of the enforcement data local agencies submitted.

Limited Searches to Find Illegal Facilities. Because vacant, affordable, temporary housing in rural areas is limited, experts believe that farm workers in many counties live in employee housing facilities operated *without* permits. In an effort to ensure that all farm workers live in decent and sanitary housing, the EHA charges enforcement agencies with locating illegal employee housing facilities. Enforcement agencies then provide assistance to owners of these facilities in identifying deficiencies and applying for permits.

In recent years, the HCD and Riverside County have had increasing success in locating illegal facilities. Despite this improvement, however, our review indicates that the EHA mandate to seek out illegal facilities throughout the state is not being carried out. Instead, enforcement activities have been concentrated to a small number of areas of the state. For example, in 1991 and 1992 nearly a quarter of *all* the illegal facilities discovered statewide were located in three small Tulare towns situated within five miles of one another (Dinuba, Orosi, and Cutler). The majority of the rest of the illegal facilities were located in Fresno, Riverside, or Kern Counties. Conversely, our review indicates that few, if any, illegal facilities were found in many other counties, including four major agricultural producers which also depend on the work of large numbers of seasonal agricultural workers: San Joaquin, Monterey, Ventura, and San Diego.

Conclusion: EHA Enforcement Needs Improvement. Given the deficiencies noted above, we conclude that enforcement of the EHA by the HCD and by some local agencies is weak and uneven and needs improvement. Below, we discuss the HCD's explanation of the problems and then outline recommendations for improvement.

HCD's Response: Not Enough Money

The HCD department staff were very helpful to us as we compiled this report. When asked to comment regarding our findings, the department staff indicated that the shortcomings we discovered stem from actions the department took to offset reduced financial support for the program. Specifically, in order to reduce costs, the department (1) left the employee housing manager position unfilled for most of the last two years and (2) reduced the level of inspections. These actions resulted in reduced program coordination and oversight—and left significant numbers of facilities uninspected.

Figure 11 illustrates the decline in program resources since 1989-90. The reductions in General Fund support are generally attributable to unallocated General Fund reductions imposed by the budget during the last few years. The constant level of reimbursement revenues reflects the decision of the administration not to increase permit fees. (Permit fees were last increased in 1980-81.) The top line shows the decline in total program revenues.

Recommendations for Improving Performance

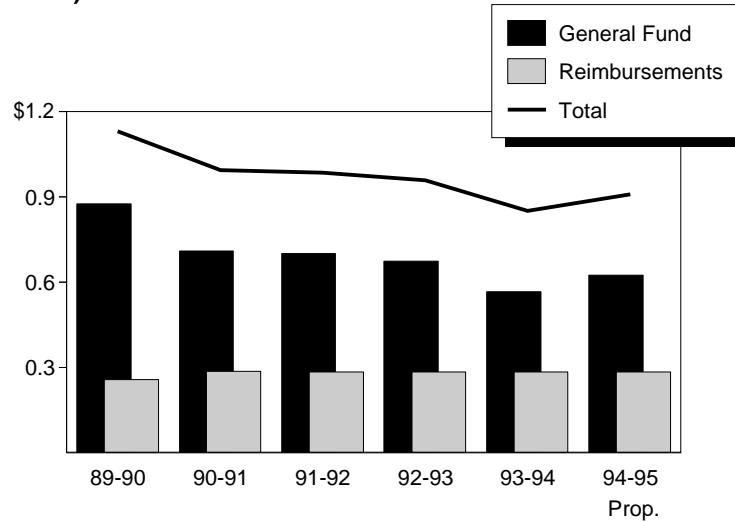
Given the many serious problems in the operation of the employee housing program, we believe the department must adopt a plan of corrective action. This plan should include three elements: (1) a proposal to bring into balance employee housing program revenues and responsibilities, (2) a coherent program management system, and (3) a task force to address data irregularities. We examine each of these below.

Bring Program Revenues and Program Responsibilities into Balance. If the HCD can not carry out its full responsibilities under the EHA with its existing level of funding, it is incumbent upon the department to submit a proposal to the Legislature for *reducing* program responsibilities or *increasing* its revenues. Our review indicates that there are at least four ways to bring about a better balance between employee housing program responsibilities and revenues. These are outlined in Figure 12. The options we present are not mutually exclusive. It may be that the best solution lies in combining a number of these options. Each of them, however, requires difficult trade-offs.

Figure 11

Funds for HCD's Employee Housing Program Have Fallen in Recent Years

(In Millions)



Consolidate Management Efforts. Currently, as we discussed above, the department does not have a manager for the employee housing program. Rather, the department has spread these responsibilities among five (higher paid) managers. Our review indicates that this division of responsibilities has greatly undermined the ability of the department to effectively manage and coordinate this program, so that the department should either fill the employee housing program manager position or reorganize its staff to consolidate responsibilities for the program.

Address Data Irregularities. Because the Legislature needs data to evaluate the employee housing program, the HCD should convene a task force of local enforcement agencies, HCD field inspectors, legislative staff, and experts on the topic of farm workers. This task force should examine the data collection efforts mandated by statute and make recommendations for needed changes.

Figure 12

Options for Bringing Employee Housing Program Revenues and Responsibilities into Balance

Proposal	Advantages	Disadvantages
Shift <i>all</i> inspection responsibilities to local governments. HCD would retain responsibility for local agency oversight and program management.	Transfer would consolidate employee housing program enforcement with local building, health and safety inspection programs. Potential for greater efficiencies.	Transfer of responsibility would require an improved program of state supervision, including a system of sanctions or incentives to ensure adequate local enforcement. Local agencies likely to charge fees in excess of current state fees, because state fees do not cover costs.
Modify employee housing permit process as follows: <ul style="list-style-type: none"> ● Issue permits by mail, upon payment of fees and self-certification by owner of compliance with housing standards. ● Inspect facilities on a selective basis. ● Revoke permits and/or impose fines on operators found with substandard facilities. ● Reinspect all facilities found with violations of employee housing standards. 	Focuses enforcement efforts on major violators of the EHA.	May result in a greater level of nonconformity with employee housing standards.
Increase permit fees.	Additional funds may enable the HCD and local governments to provide an increased level of enforcement as required by law.	Increasing cost of providing employee housing may reduce the amount of housing provided.
Increase General Fund support for Employee Housing Program.	Additional funds may enable the HCD to provide an increased level of enforcement and oversight as required by law.	State fiscal condition may prohibit increased state support.

DEPARTMENT OF INSURANCE (2290)

Insurance is the only interstate business that is regulated entirely by the states, rather than the federal government. In California, the Department of Insurance (DOI) is responsible for regulating insurance companies, brokers, and agents in order to protect businesses and consumers who purchase insurance. Currently, there are about 1,500 insurers and 264,000 brokers and agents operating in the state, generating total premiums of about \$ 60.6 billion a year.

The budget proposes total expenditures of \$118.3 million from the Insurance Fund to support the DOI in 1994-95. This is \$5.3 million, or 4.7 percent, more than estimated current-year expenditures. This increase in expenditures is due mainly to the department's increased insurance fraud control and increased activity in the regulation of insurance companies and producers. In addition, the budget proposes expenditures of about \$42 million to sustain the programs addressing auto and workers' compensation fraud.

The budget indicates that there will be a \$21.3 million reserve in the Insurance Fund at the end of the budget year. This reserve is 18 percent of the department's estimated 1994-95 expenditures. In comparison, the reserve on June 30, 1993 was \$13 million, which represented about 15 percent of 1992-93 expenditures. A major factor contributing to the higher reserve is an estimated 27 percent increase in current-year revenues over revenues in 1992-93. This increase is attributed mainly to an increase in workers' compensation assessment fees.

THE CONSERVATION AND LIQUIDATION DIVISION

The Conservation and Liquidation Division in the Department of Insurance is responsible for conserving and liquidating insolvent insurance companies. Article 14, Section 1011(i) of the Insurance Code authorizes the Insurance Commissioner to revoke the license of an insolvent insurer and, with a court order, to conserve and liquidate the assets of the company. The current department policy is to make every effort to restore insolvent insurance companies to financial health or to sell them to sound insurance carriers before initiating liquidation procedures.

The commissioner must first receive court approval to intervene and conserve the assets of an insurance company. Once under conservatorship, the commissioner operates the company and funds these operations through the assets of the company. As of November 30, 1993 the division was conserving the assets of 94 estates, totaling approximately \$753 million. These funds are not under the purview of either the administration or the Legislature.

The Legislature Should Not Approve Division's Budget Until It Receives Restructuring Plan

We recommend that the Legislature not approve the budget for the Conservation and Liquidation Division until it receives and reviews the department's plans to restructure the division.

The budget proposes a total of \$532,000 from the Insurance Fund for the Conservation and Liquidation Division. This amount is insignificant in relation to the division's actual expenditures and funding available for the division's operations. Our review of the division indicates that significant management and organizational issues need to be addressed before the Legislature approves the division's budget. These issues are discussed below.

No Meaningful Budget. Other than the \$532,000 in the state budget, the division has no meaningful budget. As previously discussed, as of November 30, 1993, approximately \$753 million was available from the estates managed by the division to support the activities of the division. The division, however, does not develop an annual budget for its expenditures from these assets. Instead, the division spends on an "as-needed" basis.

No Management Plan for Oversight of Estates. As noted above, in November 1993 the division had control over 94 estates. Some of these have been under the division for as long as 25 years. The division, however, has not established a management plan for any of these estates. Thus, division management has no systematic way to assess the progress of a particular estate. Without a management plan, with specific goals and time frames for each estate, the division cannot adequately determine whether an estate is on a timely track for restoring solvency or if and when an estate should be liquidated. This inadequate monitoring of estate assets could result in higher than necessary expenditures, which in turn would lower the return to the estate policy holders.

No Policy Procedure for Establishing Non-Civil-Service Positions. The division has no specific policies or procedures in place for determining under what conditions positions should be civil service or

non-civil service. The division currently has 98 employee positions. Seven of these positions (six are filled) are state civil-service employees, who fall under state employment conditions and are accounted for in the state budget. The remaining 91 positions are non-civil-service employees and are paid from estate assets. These personnel are not part of the state budget process. The department justifies the use of non-civil-service employees on the basis that hiring these employees is essential to meet the flexible nature of the division work. Such staffing may be justified in temporary or short-term workload situations, yet over 30 of the non-civil-service employees were hired before 1991, with one hired as long ago as 1977. This group represents a longer-term core workforce that does not appear to be justified on the basis of fluctuating workload and a consequent need for "flexibility." The department needs to develop clear policies and procedures addressing this issue.

Uncontrolled Hiring and Salary Setting. The division has no written hiring procedures and has no policy on setting non-civil-service salaries. As a result, the division chief can independently hire and negotiate salaries for all non-civil-service employees. Furthermore, there is no upper limit on the salaries which may be approved. It is our understanding that the department has hired a consultant to review current salary ranges.

Benefits More Costly for Non-Civil-Service Employees. Benefits provided to the division's non-civil-service employees are more costly than benefits provided to civil-service employees. Figure 13 presents a comparison of employee benefits for these division employees.

Based on these data, a non-civil-service employee with a \$40,000 annual salary and one dependent would receive a benefit package totaling \$2,320 more than a similar civil-service employee. (This benefit comparison includes \$2,400 annually for the non-civil-service employee's IRA. The state would contribute \$2,000 [5 percent of salary] to the civil-service employees' retirement [under tier 2], but benefits are not available to the employee unless he or she retires from state service.)

Division Chief Replaced by Highly-Paid Consultant. In August 1993, the department demoted and transferred the division chief—a civil-service employee—and gave the responsibilities of the day-to-day operations of the division to a private consultant. To fulfill the responsibilities of the division chief, this consultant was paid \$250 an hour—for up to 600 billable hours (\$150,000) or for three calendar months, whichever came first. (This contract expired November 1, 1993.) In comparison, the civil-service position carries a salary of approximately \$74,500 a year.

Figure 13

**Department of Insurance
Conservation and Liquidation Division
Staff Benefits of Civil Service
Compared to Non-Civil-Service**

	Employer Cost (Monthly)	
	Non-Civil-Service Employee	Civil-Service Employee
Medical insurance		
Employee only	\$222	\$174
Employee plus one dependent	445	323
Employee plus two or more dependents	530	410
Dental		
Employee only	11	24
Employee plus one dependent	18	44
Employee plus two or more dependents	14	64
Vision		
Employee only	12	11
Employee plus one dependent	25	11
Employee plus two or more dependents	25	11
Transportation allowance	50	—
Retirement	6% of earnings ^a	5% of earnings ^b

^a This is a ceiling.
^b Tier 2, miscellaneous classification: Public Employees' Retirement System.

Currently, the civil-service division chief position is vacant and the division is in the process of hiring a “Chief Executive Officer”—a non-civil-service position which the department has established (outside the state budget process) to run the division.

Over \$3 Billion in Assets Not Managed By the Division. Five large estates—with assets totaling approximately \$3.1 billion—are not managed by the division. Instead, these estates are managed by on-site managers appointed by the commissioner. The purpose of the Conservation and Liquidation Division is to manage the assets under state conservatorship. Consequently, it is unclear why the bulk of the assets under state conservatorship are managed outside of the division.

Legislature Needs Division Reorganization Plan. It is our understanding that the department is preparing a reorganization plan to

address these and other problems within the division. This plan should be available for legislative review prior to the hearings on the department's budget. Thus, we recommend that the Legislature not approve the division's budget until the department's plan is submitted to the Legislature for review and approval. Furthermore, the plan should specifically identify how the issues discussed above, as well as other issues addressed by the department, will be remedied by the proposed plan.

Total Budget Should Be Submitted for Legislature's Review

We recommend that the Legislature add an informational item to the Budget Bill identifying the planned budget-year expenditures from assets under conservatorship. We further recommend that in the future the Department of Finance include as an informational item a display of expenditures from these assets and associated staffing (similar to other state departments) in the Governors' Budget and Budget Bill.

The division—except for \$532,000 from the Insurance Fund—is funded through the assets of insurance companies it conserves. The division spends these “funds” with no overall expenditure plan or ceiling. While court approvals are required for some expenditures, historically the Insurance Commissioner has asked for and received court approval to spend as necessary. We believe that the expenditure of funds from assets that have been taken under state conservatorship warrants legislative oversight. As discussed above, current department practices raise serious questions over the use of conserved assets for department expenditures. In order to give the Legislature a degree of oversight on this state responsibility, we recommend that (1) the Legislature add an informational item to the Budget Bill identifying planned budget-year expenditures from assets under conservatorship and (2) the Department of Finance include the department's expenditures from these assets and associated staffing (similar to other state departments) in all future Governor's Budgets and Budget Bills as an informational item. In order for the Legislature to take this action, the department must submit budget information concerning the planned expenditures and staffing (in the division as well as for assets outside division management) in the budget year. The department should send this information to the Legislature in advance of budget hearings to allow sufficient time for legislative review.

DEPARTMENT HAS NOT COMPLIED WITH REPORTING REQUIREMENT CONCERNING WORKLOAD MEASURES

The department has not fulfilled the 1993 supplemental report requirement to report workload measures and standards to the Legislature by December 15, 1993. The Commissioner should submit this report to the Legislature prior to budget hearings.

The Supplemental Report of the 1993 Budget Act requires the Insurance Commissioner to report to the Legislature, by December 15, 1993: (1) workload measures which provide information on the level of annual work by activity and (2) workload standards that provide productivity measures for the department's staff. The Commissioner should submit this report prior to budget hearings so that the Legislature will have the information it requested before considering the DOI's budget request for the budget year.

In its major 1994-95 budget change proposals—pertaining to increased enforcement of fraudulent insurance activity—the department has failed to provide workload measures to justify new positions. Below we discuss this problem as it applies to specific proposals.

NEW POSITIONS FOR FRAUD PROGRAMS NOT JUSTIFIED

We recommend that the Legislature not approve 100 permanent positions proposed for insurance fraud programs at this time as the department has not allocated resources consistent with workload. (Reduce Item 2290-001-217 by \$9.9 million.)

The budget includes \$7.5 million and 83 new positions (63 of these were established in the current year) for the Workers' Compensation Fraud Program. The budget also includes a \$2.4 million augmentation and 17 new positions for its Automobile Insurance Fraud Program. These programs are administered by the department's Fraud Division.

Program Background. The department's workload under the Workers' Compensation and Automobile Insurance Fraud programs is dependent on the number of suspected fraudulent claims (SFCs) it receives. These claims are submitted to the Fraud Division by insurers, self-insurers, or third-party administrators who believe that the claim involves a fraudulent act. The department reports that the total number of reported SFCs has grown almost 100 percent from 1991-92 to 1992-93. Forty-one percent of this increase is in workers' compensation claims, 49 percent is in automobile insurance claims, and 10 percent is attributable to other

kinds of claims. Based on the increased number of claims, the department is requesting more positions for investigation of these two types of fraud.

Problems With the Department's Resource Allocation. The department has not effectively addressed its workload for the Workers' Compensation and Auto Insurance Fraud programs. An example of this is in the department's methodology for establishing and staffing six new offices with fraud investigators. The department proposes to establish two satellite offices—one for the Workers' Compensation Program and one for the Auto Insurance Fraud Program—in the following three locations: Fresno, San Jose, and Riverside.

According to the department's plan, the Workers' Compensation satellite offices will each have five investigators, while the Automobile Insurance satellite offices will each have three investigators. These proposed assignments, however, are disproportionate to the fraudulent activity in these areas. For example, the total SFCs for workers' compensation and automobile insurance reported from July 1991 through December 1993 in San Jose was more than *double* the amount reported in the Fresno area during this period. Also, during the same time period, the number of workers' compensation SFCs reported in Riverside constituted more than 50 percent of the SFCs reported in this area, while, in San Jose, the number of workers' compensation SFCs constituted about 35 percent of the SFCs reported in that area. Thus, although workload based on the department's measure of SFCs varies by region, the department has assigned the same number of investigators to each area. Given this disparity, it is unclear why the department has selected these areas for satellite offices, why two offices are needed in each area, or what number of investigators is needed to effectively support these offices. Moreover, it is unclear how the remainder of the 100 positions will effectively support the fraud programs as the department has assigned these positions in a way not necessarily proportional to fraudulent activity.

Positions Should Not Be Approved Until the Department Develops Appropriate Workload Measures. The public need for investigation and enforcement of fraudulent insurance activity is apparent. It is incumbent on the department, however, to give the Legislature adequate information to assure that the department's approach is effectively addressing this need. Until the department develops appropriate workload measures, the Legislature can not be certain that the new positions for the fraud programs will add value—in terms of the public benefit—to the department's enforcement of fraudulent activity. Consequently, we recommend the Legislature not approve the 100 new positions for these activities at this time. The department should address these concerns regarding its workload measures and resource allocations prior to budget hearings.

PROPOSED ENFORCED CONSERVATION UNIT NOT JUSTIFIED

We recommend the Legislature delete the \$909,000 appropriation from the Insurance Fund for the Enforced Conservation Unit because the department has not (1) justified the establishment of a special unit for this workload or (2) provided workload measures that justify additional positions. (Reduce Item 2290-001-217 by \$909,000.)

The budget proposes \$909,000 from the Insurance Fund to establish an 11 position Enforced Conservation Unit in the department's Investigation Bureau. This unit is proposed to handle asset seizure activities relating to insurers who are operating in California illegally, without license or authority. There is a public need to address the problems caused by these "hazardous" insurance companies. The department, however, has not justified the establishment of a new unit to meet this need. Furthermore, the department has not developed workload measures to justify additional positions for carrying out these duties.

Existing law authorizes the Insurance Commissioner, with a court order, to seize and conserve the assets of "hazardous" insurers. In late 1992, the Investigation Bureau was directed to go beyond the administrative remedy of obtaining cease and desist orders—which according to the department, had been inadequate to halt the operation of such illicit insurers—and to actually take possession of the insurer's premises in order to halt illegal activity. Once possession is taken, the business is phased down and all recovered assets are liquidated. In the second half of fiscal year 1992-93, the Investigation Bureau investigated and took possession of five illicit insurers. With regard to its 1994-95 workload, the bureau projects a need to process about 12 seizures. Based on recent activities of the bureau, the bureau should be able to process that much workload *without additional staff*. Furthermore, the department has not provided any data to demonstrate that the bureau is not able to perform any of its other responsibilities because of the activities related to the "hazardous" insurers or due to the lack of sufficient staff.

Consequently, we recommend that the Legislature delete the \$909,000 for the proposed Enforced Conservation Unit and 11 associated new positions.

TRADE AND COMMERCE AGENCY (2920)

The Trade and Commerce Agency is designated as the primary economic development entity for promoting the establishment, retention, and expansion of business, employment, and international trade in California. It also promotes tourism and foreign investment in the state. Furthermore, because defense conversion is a key factor in retaining and creating jobs in California, the Agency has been designated as the entity for leading the state's efforts in defense conversion.

The budget proposes expenditures of \$54.9 million from various funds for the Trade and Commerce Agency in 1994-95. This is \$3.8 million, or 7.4 percent more than the estimated current-year expenditures. The increase includes \$3.7 million from the General Fund, which is 10 percent more than current-year General Fund expenditures. The General Fund supports almost three-fourths of the agency's 1994-95 budget.

AGENCY'S EFFORTS IN DEFENSE CONVERSION

Agency's Initial Efforts Focused on Federal Technology Reinvestment Project

Under the first round of funding for the Technology Reinvestment Project—a major part of President Clinton's Defense Reinvestment and Conversion Initiative—162 awards totaling \$415 million have been granted nationwide. Of this amount, up to \$49 million was awarded to projects involving state funds.

Last March, Governor Wilson established by executive order the California Council on Defense Industry Conversion and Technology Assessment in the Trade and Commerce Agency. The governor charged the Council to recommend, by June 1, 1993 an immediate, integrated strategy for the state's defense industry conversion and reinvestment.

The Council focused initially on how to maximize the funding available under the federal Technology Reinvestment Project (TRP). Emphasizing partnerships among industry, government, and universities, the TRP funds proposals submitted by these partnerships that involve technology development, deployment or training. In federal fiscal year

1993-1994, the federal administration committed \$472 million in federal funds to the TRP for its first round of awards to these partnerships.

The Council worked to identify state funds that would potentially qualify as match in TRP proposals. By December 3, 1993, the federal administration announced 162 awards to partnerships nationwide and encumbered \$415 million of the \$472 million. Of this amount, up to \$49 million was awarded to nine projects involving state funds. Assuming the Technology Reinvestment Project finances 50 percent of the costs, the total value of these proposals involving state participation is about \$98 million. Figure 14 summarizes the initial participation in the Technology Reinvestment Project.

Figure 14

State Participation in the Technology Reinvestment Project

(Dollars in Thousands)

Source	Proposals Submitted	Proposals Approved by the TRP	State Funding Committed ^a	State Funding for TRP Awards	TRP Funding ^b
Cal Trans	64	—	\$3,518	—	—
Cal EPA	4	1	840	\$50	\$250
Employment Training Panel	11	—	14,222	300 ^c	—
Job Training Partnership Act	17	2	6,000	735	7,950
California Energy Commission	6	—	4,000	—	—
Trade and Commerce					
Defense Adjustment					
Matching Grant	—	—	1,500	—	—
Sudden and Severe					
Economic Dislocation	—	—	3,200	—	—
Strategic Technology Office	107	6	12,500	1,500	40,750
Totals	209	9	\$45,780	\$2,585	\$48,950

^a Amounts shown represent funds committed by state agencies in 1993-94. Each state agency decides its own share—ranging from 12.5 percent to 25 percent—of the total proposal cost.

^b Amounts shown assume cost-sharing of 50 percent per proposal.

^c This \$300,000 from the Employment Training Panel contributed to one of the Job Training Partnership Act proposals approved for TRP funding.

Additional Federal Funds. The federal administration recently made an additional \$120 million available to complete the first round of TRP awards. The 200 proposals involving state match that have not already received TRP funding are competing for this \$120 million. The agency has informed us that the administration is expected to announce forty awards

nationwide. It is uncertain when awards will be made for this additional funding.

The current federal budget proposes \$ 625 million for the Technology Reinvestment Project. To coordinate state matching funds for TRP awards the agency will use the Defense Conversion Matching Grant Program created by Chapter 441, Statutes of 1993 (SB 268, Roberti). This program is discussed in greater detail below.

Agency Will Oversee New Process for Defense Conversion Projects

We recommend that the Trade and Commerce Agency provide information prior to budget hearings as to how the Defense Conversion Matching Grant Program will enhance the state's efforts to maximize defense conversion funding.

Chapter 441, Statutes of 1993 (SB 268, Roberti), created the Defense Conversion Matching Grant Program to be led by the California Defense Conversion Council in the Trade and Commerce Agency. (This program, established January 1, 1994, was not in effect for the first round of Technology Reinvestment Project awards discussed above.) The program was established to provide matching grants and technical assistance—from state funding sources identified by the Council—to California nonprofit organizations, public agencies, consortia, and businesses for projects which qualify for federal funds under federal defense conversion programs. The overarching goal of defense conversion is to create or retain jobs by reallocating resources from defense-related projects to other uses.

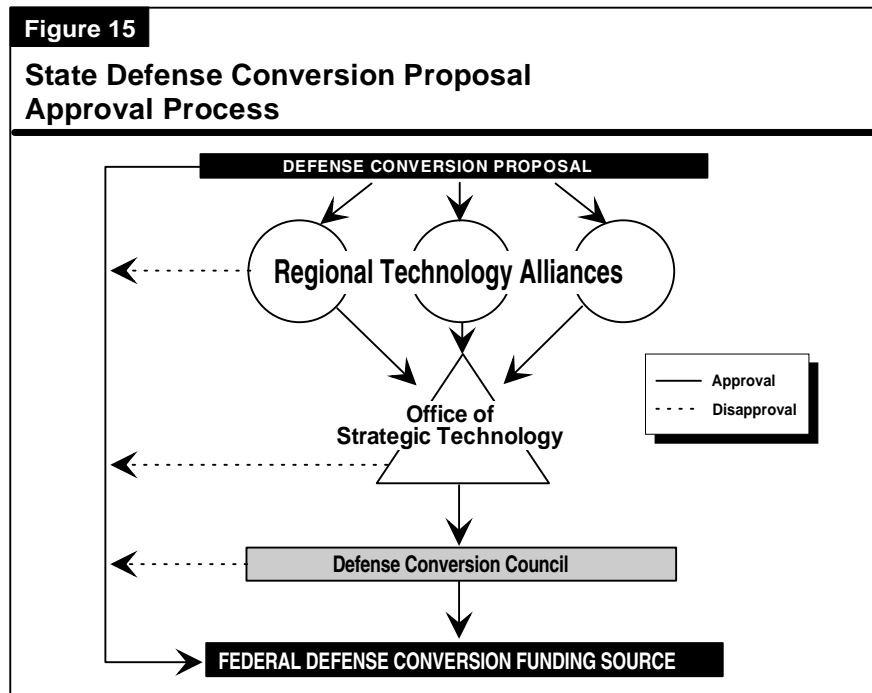
Three-Tiered Review System for Defense Conversion Matching Grant Program. The goal of the Defense Conversion Matching Grant program is to maximize state and federal funding in order to save and create jobs in California. To fulfill this purpose, the program will operate through a three-tiered project review system that is intended to coordinate and expedite the transfer of state and federal funds to state and local defense conversion projects. The three tiers of this system are:

- *Regional Technology Alliances.* Regional Technology Alliances are nonprofit organizations overseen by the Office of Strategic Technology in the Trade and Commerce Agency. So far, the Council has designated Regional Technology Alliances in the Los Angeles, San Diego, and the San Francisco Bay areas.
 - *Review Panels in the Office of Strategic Technology.* The Office of Strategic Technology will conduct review panels comprised of
-

Regional Technology Alliance representatives and other members, which may include state agency representatives.

- **The Defense Conversion Council.** The Defense Conversion Council consists of representatives from various state agencies, higher education systems, business and local government. The Council is required to establish criteria, regulations, and application procedures for the Defense Conversion Matching Grant Program. The Agency informs us that its proposed regulations are currently with the Office of Administrative Law and should be approved by the first week of February 1994.

The three-tiered review system is illustrated in Figure 15 and discussed below.



Steps in the Review Process

Proposed projects would be processed through the three-tier system as follows:

- An applicant (such as a business, local government, community, or consortia) that seeks state and federal funds for a defense

conversion project applies to its Regional Technology Alliance. The Regional Technology Alliances will rank and evaluate applications and send approved projects to the Office of Strategic Technology. (If a project is not region-specific, the applicant submits it directly to the Office of Strategic Technology.)

- Review panels in the Office of Strategic Technology will rank and evaluate proposals and submit the proposals they approve to the Defense Conversion Council.
- The Council will make final recommendations to the appropriate state agency responsible for administering the funding source. Based on these recommendations, the state agency and its partners will then apply to the appropriate federal agency for federal funding.

As shown in Figure 15, a proposal may receive state and federal funding *without* approval from the Council, the Office of Strategic Technology, or a Regional Technology Alliance. In short, the Council has the authority to recommend, but not require, funding commitments by various state agencies for defense conversion projects. As a result, defense conversion proposals may receive state and federal funding without going through the state's review process.

Kinds of Proposals Approved in the Process. Because defense conversion is broadly defined, defense conversion project proposals passing through the review process will address different areas of defense conversion, including areas that are not necessarily directly related to technology. For example, a proposal may address the needs of a small manufacturer in helping convert its defense-related product to commercial uses; or a proposal may address the needs of a community affected by military base-closure in helping it retrain its citizens. Chapter 441 directs the Council to give priority to those areas most severely affected by reductions in federal defense spending, and at the same time to provide a balance of funding across the state.

Concerns With the Process. The Defense Conversion Matching Grant program has just been established. Yet our review of the new process suggests two important areas of concern. First, defense conversion proposals can receive state and federal funds *without* going through the Defense Conversion Matching Grant review process. This raises questions concerning the effectiveness of the review process. If the process cannot evaluate and rank all potential projects, how can the agency coordinate an integrated defense conversion strategy?

Second, the Defense Conversion Matching Grant Program appears to create a cumbersome structure that could result in the delay of state and

federal funding for these proposals. It is important for the state to be able to act promptly with regard to defense conversion proposals.

In light of these concerns, the agency should inform the Legislature prior to budget hearings as to how the process will enhance the state's defense conversion efforts and place defense conversion proposals that affect the state in a better position to receive state and federal funds. The agency should also advise the Legislature of any legislative or administrative modification that would improve the Defense Conversion Matching Grant Program in order to obtain the desired results.

LEGISLATURE SHOULD CONSOLIDATE LOAN GUARANTEE PROGRAMS

We recommend enactment of legislation by July 1, 1994—to be effective January 1, 1995—transferring the California Export Finance Program to the Small Business Loan Guarantee Program. Accordingly, we further recommend (1) the deletion of the proposed \$2.8 million General Fund augmentation to the Export Finance Fund, (2) deletion of the \$1.9 million transfer from the Small Business Expansion Fund to the Export Finance Fund, and (3) a reduction of \$ 450,000 from the World Trade Commission fund to provide half-year funding for the Export Finance Program. (Reduce Item 2920-011-001 by \$2.8 million, delete transfer of \$1.9 million under Item 2920-011-918(b), and reduce Item 2920-001-981 by \$450,000.)

The budget proposes \$4.7 million (\$2.8 million from the General Fund and \$1.9 million from the Small Business Expansion Fund) for the expansion of the Export Finance Program. This program provides loan guarantees and administrative support to California exporters. The purpose of the augmentation is to provide more loan guarantees to California export businesses.

We believe the state could provide this increase in loan guarantees to exporters without a General Fund augmentation by consolidating two existing loan guarantee programs.

Program Background

The Trade and Commerce Agency oversees two small business loan guarantee programs: The California Export Program and the Small Business Loan Guarantee Program. These loan guarantees are backed by cash reserves in the California Export Fund and the Small Business

Expansion Fund respectively. Both programs perform the following functions:

- Provide loan guarantees to small businesses which otherwise would be unable to obtain loans in the conventional market.
- Leverage their share of the guarantee funds to a maximum of 4 to 1 (that is, four dollars of a loan can be guaranteed for one dollar in the guarantee fund).

The Export Finance Program is administered by the Export Finance Office located in the Los Angeles area. The office provides loan guarantees exclusively to small- and medium- sized export businesses and its staff is supported by the World Trade Commission Fund.

The Small Business Loan Guarantee Program is administered by eight regional development corporations regulated by the agency. This program provides loan guarantees to different kinds of small businesses. The staff for these corporations are supported by the interest income earned on the portion of the Small Business Expansion Fund each corporation administers.

Purpose of Budget Augmentation to Export Finance Fund

The budget proposes a \$2.8 million General Fund augmentation for the Export Finance Fund. In addition, the budget proposes that \$1.9 million be transferred from the Small Business Expansion Fund to the Export Finance Fund. This \$1.9 million is part of a \$7.5 million appropriation to the Small Business Expansion Fund by Chapter 866, Statutes of 1993 (AB 1259, Katz). Chapter 866 provided that up to \$7.5 million, attributable to state retail sales tax increases in 1993 due to the federal gas tax increase, be transferred from the Retail Sales Tax Fund to the continuously appropriated Small Business Expansion Fund. Money in the Small Business Expansion Fund, administered by the Trade and Commerce Agency, is continuously appropriated to make loans, guarantees, and restricted investments for small business development corporations.

The reason for this \$4.7 augmentation to the Export Finance Fund is to increase the number of loan guarantees to California export businesses. Currently, the \$6.5 million in the fund is fully leveraged to the authorized 4 to 1 ratio, providing total loan guarantee authority of \$26 million. This program has been able to maximize its loan guarantee authority because it specializes in backing loans to small export businesses that are viewed by conventional lenders as "lower-risk." The agency wants to increase this loan guarantee authority to \$44.8 million with the \$4.7 budget augmentation.

Small Business Guarantee Fund has not reached maximum guarantee authority. The Small Business Loan Guarantee Program uses a trust fund supported by the Small Business Expansion Fund, to provide loan guarantees to different kinds of small businesses. Currently, the amount in this fund is approximately \$30.7 million, and it provides loan guarantee authority of \$36.3 million. This is less than a 1.2 to 1 leverage ratio. Historically, the trust fund has been near or below a 1.1 to 1 leverage ratio. The fund has not reached the maximum 4 to 1 leverage ratio because banks (or conventional lenders) are reluctant to make these "higher-risk" loans unless there are sufficient funds to guarantee them on a dollar for dollar (1 to 1) basis.

Consolidate Two Loan Programs

Instead of augmenting the Export Finance Program, we recommend that its responsibilities be transferred to the Small Business Loan Guarantee Program. This would allow the agency to avail itself of *existing* loan capacity and save on program administration costs.

Loan Capacity. As discussed above, the trust fund has been leveraged at a ratio close to 1 to 1, while it is authorized to reach a ratio of 4 to 1—which would provide over \$122 million in total guarantee authority. Therefore, this fund currently has the guarantee authority to support the increased loan guarantees to California exporters proposed in the budget while still leaving plenty of authority for "high-risk" businesses in need of loan guarantees. In effect, the state would just better leverage existing loan guarantee authority under our proposal.

Increased Administrative Efficiency. The state would also realize savings through lower administrative costs from having a single, more efficient small business loan guarantee program. Moreover, the state's loan guarantee service would improve as regional development corporations could serve as "one stop shops" across the state for all eligible businesses, including California exporters, seeking loan guarantees.

For these reasons, we recommend that the Legislature enact legislation transferring the Export Finance Program to the Small Business Loan Guarantee Program effective January 1, 1995. We further recommend the Legislature delete the \$2.8 million General Fund augmentation to the Export Finance Fund and delete the \$1.9 million transfer from the Small Business Expansion Fund to the Export Finance Fund. Finally, we recommend that the Legislature provide half-year funding for the Export Finance Program in order to phase out the administration of the program.

INFORMATION NEEDED ON SURETY BOND PROGRAM

We recommend that the Legislature not approve the \$4.2 Small Business Expansion Fund appropriation for support of the Surety Bond Program until the administration develops a proposal for this program and submits it to the Legislature.

The budget proposes \$4.2 million from the Small Business Expansion Fund for the support of the Surety Bond Program. Chapter 866, Statutes of 1993 (AB 1259, Katz), appropriates funding from the Small Business Expansion Fund to guarantee loans as well as surety bonds. The agency has informed us that a Surety Bond Program will help small businesses obtain necessary bonding by guaranteeing 90 percent of any surety company's losses for bonds issued to those small businesses. Also, the agency has indicated that the plan for spending these funds will not be finalized until September 1994.

At the time this analysis was prepared, this is the only information the agency had developed on the Surety Bond Program. Until the agency has prepared a plan for the program and submitted it to the Legislature, there is no way of knowing what the state is buying for its dollars. Consequently, at this time we recommend that the Legislature not approve the \$4.1 million Small Business Expansion Fund appropriation for this program. When a plan is available, we will review it and, as appropriate, make recommendations to the Legislature.

GENERAL FUND SUPPORT FOR PERMIT STREAMLINING PROGRAM IS NOT JUSTIFIED

We recommend deletion of \$1.1 million from the General Fund requested for a local permit streamlining program because the agency has not justified the effective use of this appropriation. (Reduce Item 2920-101-001 by \$1 million and Item 2920-001-001 by \$0.1 million.)

The budget proposes a \$1.1 million General Fund appropriation for a local permit streamlining program. This program would allow local agencies to apply for grants of up to \$50,000 a year to implement local permit streamlining programs.

No Clear Goals or Expectations. The agency's local permit streamlining program is designed to give grants of up to \$50,000 to local agencies which apply to the program. The agency claims that \$50,000 is the appropriate amount based on past economic development grant programs. The agency, however, has not defined its expectations for the

program nor established a methodology for assessing effective use of the grants. As a result, there are no clear goals or expectations of what benefits will be realized after the expenditure of the \$1.1 million. Consequently, we recommend that the Legislature delete the \$1.1 million General Fund appropriation for the local permit streamlining program.

ELIMINATE OFFICE OF CALIFORNIA-MEXICO AFFAIRS

We recommend deletion of the \$258,000 General Fund proposal for the Office of California-Mexico Affairs because the responsibilities of the office can be assumed by the agency and its existing staff. (Reduce Item 2920-001-001 by \$258,000 and eliminate 1.9 personnel years.)

The budget proposes \$258,000 for support of the Office of California-Mexico Affairs. Chapter 1197, Statutes of 1982 (AB 2716, Kapiloff) established the office to be responsible for coordinating a variety of activities regarding California-Mexico relations on behalf of the Governor. In 1993, the Governor, by executive order, transferred the office to the Trade and Commerce Agency.

Traditional Responsibilities of Office. The Office of California-Mexico Affairs was established to (1) represent the state and the Governor on border issues, (2) participate on behalf of the Governor and the State of California in official forums, and (3) encourage business ventures that are mutually beneficial along the border. The office is located in San Diego and is currently staffed with two people.

Current Programs Can Fulfill Office Responsibilities. In addition to the \$258,000 for the Office of California-Mexico Affairs, the agency's budget includes a total of approximately \$1.1 million and 14 positions for offices that are already involved with California-Mexico relations. These offices are: The Office of Foreign Investment, The Export Development Office, and the Mexico Office of Investment and Trade. In our view, these offices can easily carry out the responsibilities of the Office of California-Mexico Affairs. For example, the Mexico Office of Investment and Trade could cover border issues as they relate to joint businesses ventures. Also, in its efforts to strengthen foreign communications, the Office of Foreign Investment could represent the state in the official forums relating to California-Mexico Affairs.

In short, the agency has adequate resources available to assume the responsibilities of the Office of California-Mexico Affairs. Therefore, we recommend that the Legislature delete the \$258,000 and 1.9 positions.

TOURISM PROGRAM SHOULD BE FUNDED THROUGH FEES

We recommend the Legislature enact legislation to establish tourism industry fees in order to finance the tourism program. Accordingly, we recommend the Legislature reduce the requested \$7.5 million from the General Fund by \$3.8 million and increase reimbursements by \$3.8 million. (Reduce Item 2920-001-001 by \$3.8 million.)

The budget proposes a \$ 7.5 million General Fund appropriation for the Office of Tourism in the California Trade and Commerce Agency. This program was established to create jobs and tax revenues for California by stimulating economic activity through increased tourism expenditures. To increase tourism expenditures, the program operates a marketing strategy to promote California as a travel destination. Under current law the office is required to identify resources, from both public and private sources, to accomplish this promotion and marketing strategy.

Tourism Fees Should Result in Savings to General Fund. As discussed above, the Office of Tourism is required to identify private funding sources to accomplish the promotion of tourism in the state. We believe it would be appropriate for the state to establish a tourism industry fee program to support these promotional activities. In this way, the tourism industry, which most directly benefits from these promotions, would pay for these activities rather than the state's General Fund.

Accordingly, we recommend the Legislature enact legislation to establish tourism industry fees in order to finance the tourism program. To initiate this effort in the 1994 budget, we recommend that the Legislature fund one-half year of the tourism program from the General Fund in 1994-95—reduce Item 2920-001-001 by \$3.8 million and increase reimbursements by \$3.8 million. In the future, this program should be financed entirely through these fees.

We would also note that the Governor's budget document proposes the enactment of legislation to create a self-assessment mechanism on California's tourism industry to support the tourism program.

AGRICULTURAL LABOR RELATIONS BOARD PUBLIC EMPLOYMENT RELATIONS BOARD (8300 AND 8320)

Agricultural Labor Relations Board. The Agricultural Labor Relations Board (ALRB) protects the rights of agricultural workers to join employee unions, bargain collectively with their employers, and engage in activities through labor organizations of their own choosing. In order to accomplish its work, the agency is split into two divisions: (1) the General Counsel, whose employees run elections and investigate charges of unfair labor practices, and (2) the board, which certifies elections, and adjudicates and mediates unfair labor practices.

The budget proposes General Fund expenditures of \$4.3 million for the support of the ALRB in 1994-95. This represents an increase of \$158,000 (3.8 percent) over estimated current-year expenditures.

Public Employment Relations Board. The Public Employment Relations Board (PERB) protects the rights of public education and state employees to join employee organizations and engage in collective bargaining with their employers regarding salaries, wages, and working conditions. It does so by administering three state laws: (1) the Education Employment Relations Act, covering K-14 school employees; (2) the Ralph C. Dills Act, covering state civil service employees; and (3) the Higher Education Employer-Employee Relations Act, covering University of California and California State University employees. Like the ALRB, the PERB reviews, mediates, and, if needed, adjudicates charges of unfair labor practices and conducts employee union elections.

The budget proposes General Fund expenditures of \$4 million for support of the PERB in 1994-95. This represents an increase of \$131,000 (3.3 percent) over estimated current-year expenditures.

Eliminate the ALRB and Transfer Its Remaining Duties to the PERB

Our review of the ALRB's program shows a significant decline in workload, beginning in the early 1980s and continuing through the

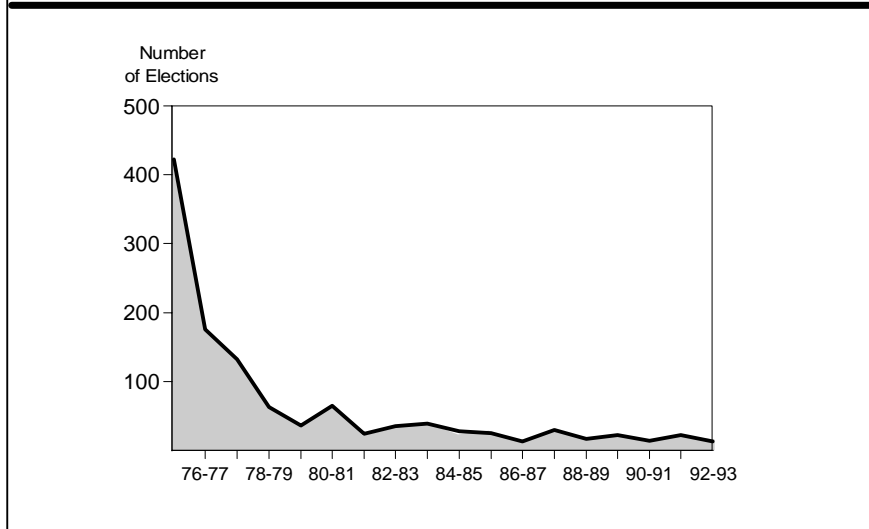
current fiscal year, a condition which leads us to recommend legislation eliminating the board and transferring its duties to the PERB. This would result in budget-year savings to the General Fund of \$990,000 and future annual savings of \$1,980,000. (Reduce Item 8300-001-001 by \$2,150,000 and increase Item 8320-001-001 by \$1,160,000.)

The ALRB was created in 1975 with the passage of the Agricultural Labor Relations Act (Ch 1/75, 3rd Extraordinary Session). The ALRB's workload consists of (1) certifying farm worker union elections, (2) adjudicating unfair labor practices, and (3) collecting restitution from farm employers found guilty of inequitable treatment of farm workers.

Our review of the board's two major workloads—election certification and unfair labor practice complaints—shows a dramatic falloff after an early flurry of cases in the years immediately following passage of the Agricultural Labor Relations Act in 1975. For example, Figure 16 shows that ALRB election certifications peaked in the years immediately following the creation of the ALRB (1975-77), then declined sharply and permanently. Figure 17 indicates a similar pattern regarding the number of unfair labor practice charges and complaints. When an alleged unfair labor practice occurs, the aggrieved individual, or his or her union representative, files an unfair labor practice charge with the

Figure 16

**Agricultural Labor Relations Board
Elections Held
1975-76 Through 1992-93**



ALRB. The board's General Counsel then determines whether the charge has merit, in which case a complaint is issued. Figure 17 shows that the numbers of charges and complaints have declined at sustained sharp rates since 1975. Total ALRB staffing levels have followed a similar course.

Figure 17

**Agricultural Labor Relations Board
Charges to Complaint and
Complaints Issued
1975-76 Through 1992-93**

Fiscal Year	Charges to Complaint	Complaints Issued	Personnel-Years ^a
1975-76	258	147	—
1976-77	364	141	—
1977-78	321	111	227.0
1978-79	348	138	189.0
1979-80	440	131	177.7
1980-81	313	86	170.0
1981-82	333	109	197.7
1982-83	189	71	189.7
1983-84	157	57	148.7
1984-85	122	48	134.8
1985-86	74	38	132.5
1986-87	46	28	113.5
1987-88	46	32	106.5
1988-89	40	22	91.2
1989-90	95	25	87.6
1990-91	70	22	87.2
1991-92	72	31	68.3
1992-93	50	28	46.8
Average Annual Decline	-9.2%	-9.3%	-10.0%

^a ALRB start-up did not result in peak staffing until 1977-78.

All these changes have left the ALRB's five-member board (two board appointments are vacant and have been vacant for over two years) with relatively little to do. For example, during all of 1992-93, the board made 13 unfair labor practice decisions and ten election decisions. Through December of the 1993-94 fiscal year, the board had rendered six unfair labor practice decisions and two election decisions.

The state of the ALRB's workload calls into question the continued need for a state agency devoted solely to farm labor activity. Moreover, there are clear similarities between the duties of, and subject matters dealt with by, the ALRB and the PERB. Important work remains in enforcing the Agricultural Labor Relations Act, and the PERB has the structure and expertise to extend its purview to include enforcement of the act.

Given this situation, we believe an opportunity exists to achieve economies by merging the activities of the two boards into one. Specifically, our review indicates that the work of the ALRB board members and their legal and administrative support positions could be absorbed by the PERB. The ALRB currently spends almost \$2 million on these functions. Furthermore, we believe additional economies of scale would be available through the elimination of duplicative administrative positions (such as personnel and budgeting positions). At this time, however, we cannot determine the number of such positions that should be reduced.

Recommendation. In view of the above, we recommend that the Legislature enact legislation to eliminate the ALRB—as of January 1, 1995—and move its residual functions and workload, with necessary staff (27 positions), to the PERB. Accordingly, we recommend the Legislature reduce Item 8300-001-001 by \$2,150,000 (half-year funding) and increase Item 8320-001-001 by \$1,160,000. This recommended consolidation would save the General Fund at least \$990,000 in 1994-95, with annual savings of \$1,980,000 in future years, due to the elimination of the ALRB board and related staff. We also recommend that the legislation include those changes needed to conform the Agricultural Labor Relations Act with the transfer of enforcement to the PERB.

In addition, the PERB should advise the Legislature, prior to budget hearings, regarding which positions would be duplicative of current PERB administrative positions. The PERB, in consultation with the ALRB, should also advise the Legislature about the need to continue funding of the ALRB's three regional offices, and whether closings or consolidations are in order. It is probable that, based on such information, the Legislature will be able to reduce the funds transferred to PERB even further, either in 1994-95 or 1995-96.

DEPARTMENT OF INDUSTRIAL RELATIONS (8350)

The objective of the Department of Industrial Relations (DIR) is to protect the workforce of California, improve working conditions, and advance opportunities for profitable employment. These responsibilities are carried out through three major programs: the adjudication of workers' compensation disputes; the prevention of industrial injuries and deaths; and the enforcement of laws relating to wages, hours, and working conditions.

In addition, the department (1) regulates self-insured workers' compensation plans, (2) provides workers' compensation payments to injured workers of uninsured employers and other special categories of employees, (3) offers conciliation services in labor disputes, (4) promotes apprenticeship programs, and (5) conducts and disseminates labor force research.

The budget requests an appropriation of \$181.6 million in 1994-95, a 13 percent increase over estimated current-year expenditures. The request includes a \$140.5 million General Fund appropriation, a 12 percent increase over estimated current-year expenditures.

Impact of Workers' Compensation Reform

Budget augmentations proposed for the DIR in 1994-95 reflect, for the most part, the costs of implementing workers' compensation reform.

The Legislature approved reform measures in 1993 to reduce workers' compensation insurance premiums paid by California employers and to limit future premium growth. The implementation package attempts to achieve this goal by:

- Reducing by 7 percent the statutorily determined "minimum-rate" premium restriction effective July 16, 1993.
 - Eliminating, effective January 1, 1995, the minimum-rate law thereby letting market forces and competition govern premium prices.
 - Reducing fraud by, among other things, strengthening the regulation of workers' compensation medical examiners.
-

- Capping the number of medical examinations employers are required to pay for when there is a disputed claim.
- Authorizing the opportunity and providing the incentive for employers to contract with managed care health providers.
- Making hazardous workplaces safer.

While the legislation decreases insurance premiums paid by employers, workers injured on the job also will gain from scheduled increases in benefits.

The general expectation is that the recent workers' compensation reforms will save employers an estimated \$1.5 billion in annual workers' compensation premiums. This expected savings represents 14 percent of the estimated \$11 billion in total workers' compensation insurance premiums paid annually in California.

The proposed budget for DIR includes \$26.2 million to carry out DIR's portion of the reform package. This funding includes:

- \$16 million (\$12.2 million General Fund) to fund anticipated increases in the DIR's claims adjudication, information assistance, and benefit determination workload, and to create a new division to extend the managed care concept of medical service to the workers' compensation system.
- \$8.3 million to fund a workplace safety compliance and expanded consultation program for "high-hazard" employers.
- \$1.1 million to fund increased general administration needs related to the addition of new positions.
- \$843,000 for the Commission on Health and Safety and Workers' Compensation's program for issuing workplace-safety grants to California employers and for an annual report on the efficiency of the state's workers' compensation program.

IMPLEMENTATION OF NEW WORKPLACE SAFETY PROGRAM NEEDS MODIFICATION

Our review of the Division of Occupational Safety and Health (DOSH) expanded workplace safety program indicates that certain changes in the proposed implementation could make the program more effective. The DIR should advise the Legislature of various alternatives to improve the program. Therefore, we withhold recommendation on the \$8.3 million requested for this program, pending receipt of this information.

The budget proposes \$8.3 million and 116.8 personnel years to expand the DOSH's workplace safety program for employers with records of operating unsafe workplaces. Under the proposal, these high-hazard employers will pay an average annual fee of \$600 to fund \$8 million in program costs (the division proposes to levy the fee based on an employer's payroll rather than risk). The remaining \$300,000 of the proposal would be paid by insurers to fund a program to control workers' compensation losses. Chapter 1241, Statutes of 1993 (SB 147, Johnston) provided the DOSH with a \$4 million General Fund loan for the start-up costs of the workplace safety program.

This new workplace safety legislation requires the DOSH to: (1) provide workplace safety compliance inspections to the most hazardous employers; (2) expand an existing program to provide safety consultations to employers that request it; and (3) certify that workers' compensation insurers offer meaningful and worthwhile safety programs to their premium payers.

User Fees Levied to Fund Program

To pay for the inspection and consultation workplace-safety programs, the Legislature approved levying user fees on employers who have experienced the highest rate of workers' compensation claim losses. The legislation targets any employer with an "experience modification" factor of 1.25 or above to pay a fee to fund the workplace safety program. An experience modification ("ex-mod") factor measures the occurrence of employer loss due to workers' compensation claims among similar groups of employers. A factor of 1.0 equals the statistical average within a specific industrial classification, factors below 1.0 identify companies safer than average, and factors above 1.0 identify companies more hazardous than average.

By using ex-mod factors, there is no penalty placed on employers in inherently dangerous lines of work. Construction firms, for example, are measured against construction firms to take into consideration the occupational safety characteristics of that industry. Ex-mods are used by insurance carriers to help calculate an employer's premium. For example, a company with an ex-mod of 1.0, the statistical average, pays the basic insurance premium established for that industry. A company with an ex-mod of 1.25, however, will pay a premium that is 25 percent higher than average, while a company with an ex-mod of .9 will pay a premium that is 90 percent of the average.

There are nearly 560,000 employers in the state that purchase workers' compensation insurance. Of this total, only 130,000 (23 percent) currently receive an ex-mod factor. This is because the Workers' Compensation Insurance Rating Bureau (WCIRB), the organization which calculates the ex-mod factors, only provides ex-mod ratings to companies that paid a total annual premium over a predetermined amount in prior years. In 1992, for example, this premium threshold was \$21,600. Consequently, 77 percent of the employers (those paying less than \$21,600 annually for insurance premiums) at this time are not part of this program. Of the 130,000 employers with ex-mod factors, 13,000 have ratings above the 1.25 threshold. These employers will be assessed the fee to pay for the workplace safety program.

In addition, self-insurers are not yet included. As required by Chapter 121, Statutes of 1993 (AB 110, Peace), the division is developing the means for assigning a measurement equivalent to the ex-mod factor to self-insured employers. Self-insured employers represent only a small fraction of the total employer population. There are currently 1,400 private employers and 2,500 public employers, out of the 560,000 employers, that self-insure their workers' compensation liability.

As part of the program financing plan, the legislation limited the aggregate amount of revenue DIR can collect in any year from its targeted inspection and consultation assessments. Pursuant to the law, the total assessment in any year may not exceed 50 percent of the DOSH's 1993-94 General Fund appropriation, as adjusted for inflation. Using this formula, the DOSH estimated its 1994-95 funding limit to be \$8 million, and set fees at an annual average amount of \$600. We estimate that DOSH could collect \$9.1 million from the targeted inspection and consultation assessments, or 14 percent more than currently proposed. If they did so, the average annual fee would increase to \$700, a difference of \$100 per high-hazard employer.

New Workloads Under the Workplace Safety Program

As noted above, the DOSH has requested 116.8 new personnel years to implement the program. The proposal primarily consists of 30 safety engineers to perform inspections (resulting in about 1800 inspections annually) and 40 safety engineers to perform consultation services (resulting in about 2400 consultations annually).

Consultations. Any of the 13,000 "pool" of high-hazard employers is entitled to ask the DOSH to provide safety consultation services. The reform legislation provides high-hazard employers the incentive to seek consultation and avoid possible penalties following an inspection (which can reach as high as \$70,000 per violation). The division's implementation program assumes that most employers will ask for such services. Even so,

the division's requested level of staffing will only allow for about 2,400 consultations a year.

Inspections. Inspections would be targeted to the most unsafe and hazardous employers, as determined by ex-mod factors and other indices, within the 13,000 employers. However, in lieu of being subject to an inspection and the possibility of fines and penalties, any of these 13,000 employers targeted for inspection can ask for, and the DOSH is required to provide, a safety consultation service.

Concerns With the Program. We have concerns about aspects of the DOSH's enhanced workplace safety program. First, the proposed program will only be able to provide services to a relatively small portion of the pool of high hazard employers. This raises questions as to (1) why the division did not maximize the fee revenues available to it and (2) whether it is appropriate to charge all these employers a fee which is not scaled to reflect whether or not an employer will receive an inspection or consultation.

Second, it's unclear whether the division's proposed allocation of staffing meshes with the likely workload. As noted above, the incentives are for employers to request consultations, which could require the use of all the division's additional resources. Finally, it's not clear how many inspections the division will do, or how the division will follow up on consultations.

In light of these concerns, we recommend that prior to budget hearings the DOSH report to the Legislature on possible modifications to the current implementation plan. The report should address at least the following:

- The effect of assessing the maximum fees authorized under existing law.
 - The effects of varying the fee schedule so that the most hazardous employers, those who should most likely receive an inspection or consultation, pay a higher fee.
 - Policies the DOSH can implement to assure that consultations are provided on a priority (high hazard) basis, inspections are conducted as needed (with guidelines as to how this will be determined) and the process to be used to follow-up on the success of the consultation (with specifics on how success will be measured).
 - Changes that would provide the organizational flexibility allowing safety engineers to move from providing inspections to providing consultations, depending on the workload.
-

The DIR should provide this information prior to budget hearings. Pending receipt of the requested information, we withhold recommendation on the requested \$8.3 million.

LEGISLATURE NEEDS TO KEEP ABREAST OF WORKERS' COMPENSATION REFORM IMPLEMENTATION

We recommend that the department submit an annual report to the Legislature identifying the status of implementation and an evaluation of the various elements of the recent workers' compensation reform.

Reform of the state's workers' compensation system presented the DIR with new and extensive responsibilities. Translating those responsibilities into workload estimates, however, presented the DIR with a difficult task. Our review of the DIR's workers' compensation reform implementation indicates that the department has made a reasonable proposal to meet its projected workload. Given the large amount of forecasting that went into the department's proposal, however, it is likely that periodic adjustments will be required. This is especially relevant since the implementation's progress and the effects of the reform, which are beginning to be paid for in 1994-95, will not become known for two to three years.

In light of this fact, we recommend the Legislature approve supplemental report language requiring the DIR to make an initial report to the Legislature by December 1, 1994, followed up with reports on implementation by December 1, 1995 and 1996. These reports should, at a minimum, provide the following detail:

- Status of department's effort to fill new staff positions.
- Projected savings or additional costs associated with the various elements (such as with the new programs in the area of managed care, targeted inspection and consultation, and dispute-claim resolution.)
- Recommendations for further modification of workers' compensation to either meet the anticipated results of the recent reforms or to further improve the system.

DEPARTMENT OF FOOD AND AGRICULTURE (8570)

The Department of Food and Agriculture (DFA) promotes and protects the state's agriculture industry, develops California's agricultural policies, and assures accurate weights and measures in commerce. The department also supervises the county agricultural commissioners and county sealers of weights and measures.

The budget requests \$187.6 million for the DFA in the budget year, an increase of 7 percent over estimated current-year expenditures. The budget total includes a General Fund appropriation of \$69 million, an increase of 10 percent over estimated current-year General Fund expenditures.

MEDFLY ERADICATION AND CONTROL PROGRAMS

Background

The department has been waging a continuous campaign against the Mediterranean Fruit Fly (Medfly) since 1975, the first year the pest was detected in California. The intensity of eradication efforts has fluctuated over the intervening years, depending on the degree of infestation. Figure 18 shows the number of Medflies which have been caught in the DFA's traps since 1975.

The DFA shares Medfly program costs and responsibilities with the United States Department of Agriculture (USDA) through a cooperative funding agreement. The USDA has committed to a dollar-for-dollar expenditure match with the DFA. Figure 19 shows expenditures from all sources for fighting Medfly infestations since 1980. As shown in Figure 19, the DFA has spent \$45.6 million from the General Fund since 1987 and expects to spend another \$31 million from the General Fund in the current and budget years combined. Total costs from all fund sources through the budget year will be nearly \$260 million.

Figure 18

**Capture of Medflies in California
1975 Through 1993**

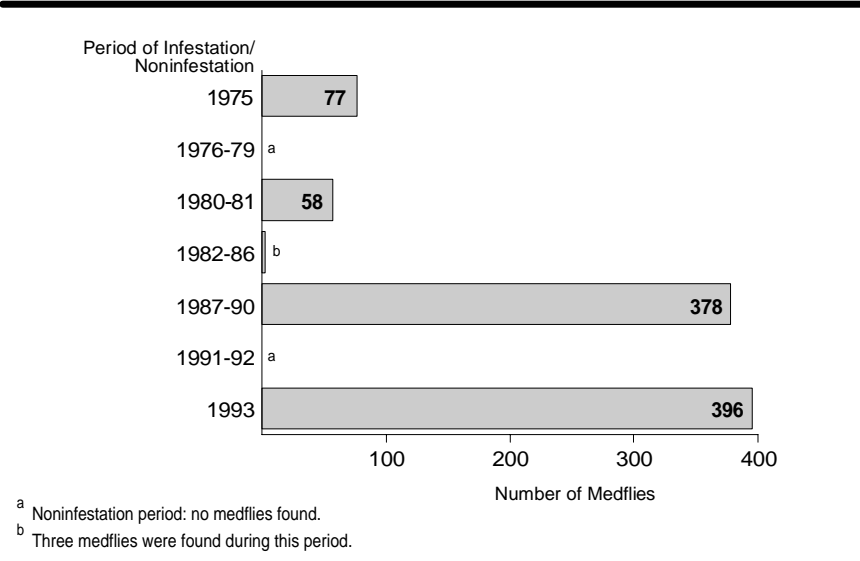


Figure 19

**Historical Medfly Expenditures
1987-88 Through 1994-95**

(Dollars in Thousands)

Fiscal Year	State Funds			Total
	Gas Tax	General Fund	USDA	
1980-86 ^a	—	—	—	\$100,000
1987-88	\$756	\$294	\$1,050	2,100
1988-89	757	922	1,679	3,358
1989-90	563	19,999	21,336	41,898
1990-91	599	9,659	9,484	19,742
1991-92	428	2,429	3,606	6,463
1992-93	1,002	12,324	19,458	32,784
Subtotals	(\$4,105)	(\$45,627)	(\$56,613)	(\$206,345)
1993-94 (estimated)	—	\$14,000	\$3,579	\$17,579
1994-95 (proposed)	—	17,000	17,000	34,000
Totals	\$4,105	\$76,627	\$77,192	\$257,924

^a The only cost data available prior to 1987 show that the Santa Clara infestation was eradicated between 1980-82 and cost \$100 million. The source of these funds was not identified.

Current Infestation Problem

The latest Medfly infestation covers a contiguous area of 1,400 square miles in Los Angeles, Orange, Riverside, and San Bernardino Counties. The first flies of the current infestation were trapped by the DFA in July 1993. The department reports it has since trapped a total of 396 Medflies. The DFA's effort to combat the current infestation is not scheduled to conclude until February 1996, which would require further program funding in 1995-96.

The DFA has already committed \$9.7 million (General Fund) in the current year, with another \$4.2 million scheduled pending approval of a deficiency request. If authorized, it would bring total 1993-94 General Fund spending to nearly \$14 million. The budget includes another \$17 million for 1994-95. As referenced above, there will be a need for an unknown amount in 1995-96 in order to complete the current program. Thus, based on current estimates, the state will have to commit in excess of \$30 million in General Fund revenue to combat the Medfly infestation discovered in July 1993. The cumulative amount of spending in this latest bout with the Medfly will exceed \$50 million when the USDA's match is taken into account.

Legislature Should Reconsider Funding Mix for Medfly Spending

We recommend that the Legislature enact legislation authorizing the DFA to assess the agricultural industry for 50 percent of the cost of the Medfly program. To implement this in the budget, we recommend the Legislature structure 50 percent of the \$17.5 million General Fund appropriation in Item 8570-001-001 as a loan, repayable January 1, 1995.

The urgency attached to eradicating the Medfly is a product of the DFA and agricultural industry claims that to allow the Medfly to establish itself in California would significantly harm California's \$18 billion agricultural industry. Specifically, the DFA claims that an established Medfly population would imperil future crop yields and close foreign and domestic markets to California-grown fruits and vegetables. Some researchers in the scientific community resist depicting the threat from the Medfly in such stark terms, but acknowledge the economic need to control the Medfly.

The question of whether the state can eradicate the Medfly or merely control it is for the most part a scientific decision. How spending on such efforts is classified, however, has come to have critical importance for who bears the costs. The DFA states it has an internal policy providing that the *state* finances pest *eradication* projects and the *agriculture industry*

pays for pest *control* projects. Thus, under DFA's policy, the state either pays for 100 percent of program spending—if classified as eradication, or nothing—if classified as pest control.

Legal Authority. The DFA's internal policy, however, is not consistent with the department's statutory authority. The statute allowing the DFA to enter into its current cooperative agreement with the USDA (Food and Agriculture Code Section 482(a)), also permits the department to enter into similar agreements with the federal government or the agricultural industry to finance either an eradication or *control* program. Section 482(a) states: "The Director of Food and Agriculture may enter into cooperative agreements with individuals, associations, board of supervisors, and with departments, divisions, bureaus, boards, or commissions of this state or of the United States for the purpose of eradicating, controlling, or destroying any infectious disease or pest within this state." Federal statutes confer similar flexibility for USDA to enter into cooperative agreements with any group which feels compelled, by self-interest or the law, to participate in pest eradication or control programs.

In other words, existing law provides the state complete flexibility in deciding how program spending should be financed. Given that the state does not have to take an "all-or-nothing" approach to pest eradication and control spending, the Legislature may want to re-evaluate its approach to state financial participation.

For instance, instead of basing decisions on the *type* of spending (eradication versus control), it may make as much sense to consider such factors as:

- How widespread the threat is (affects one crop, several crops, or is a pervasive threat to agriculture).
- The level of total spending (on a year-to-year basis or over time) needed.
- The duration of needed spending.

In the case of the Medfly program, for instance, a significant state share can be justified on the basis of the significant threat the pest poses to the California economy. On the other hand, the agriculture industry also has a huge stake in the Medfly program, and the public sector has already picked up almost \$260 million in expenses.

There is no "right" answer to what share of costs the state should bear. We believe that, based on the factors noted above, a case can be made to have the state and the industry share equally in future costs of the program. Accordingly, we recommend enactment of legislation, effective July 1, 1994, authorizing the DFA to begin assessing the agricultural

industry for 50 percent of the Medfly program funding beginning in 1994-95. To implement this in the budget year, we further recommend that the Legislature structure half of the \$17 million appropriation requested in the budget year as a loan to be repaid from the Agriculture Fund by January 1, 1995. Adoption of this recommendation would result in savings of \$8.5 million related to 1994-95, with unknown future savings.

To implement this proposal, we recommend the Legislature add the following Budget Bill language to Item 8570-001-001:

Of the amount appropriated in this item, \$8.5 million shall be a loan from the General Fund to pay for activities under the Medfly eradication program. The loan shall be repaid by January 1, 1995 with interest calculated at the Pooled Money Investment Account Rate.

The DFA Should Report on Cost Differences Between Eradication and Control Programs

We recommend that, prior to budget hearings, the DFA report to the Legislature on the programmatic and cost differences between Medfly eradication and control programs.

The distinction between whether the state's Medfly program ought to be classified as "eradication" or "control" has been a topic of debate and discussion among scientists. Most researchers believe DFA's imperative ought to be to pursue an eradication program, and that this option has proved successful in the past. Some scientific evidence has been presented, however, that indicates the Medfly is an established pest. Indeed, the Secretary of the Department of Food and Agriculture, Henry Voss, conceded that possibility in testimony given April 17, 1990 before the Joint Legislative Budget Committee. Responding to a question about the 1989-90 infestation, Secretary (then Director) Voss said: "If we're not successful in this current effort, I think then we have to seriously look at living with the Medfly from then on."

Our analysis indicates that the DFA's reliance on the "control or eradication" distinction as a trigger for funding decisions is not consistent with the department's statutory authority, as discussed above. Regardless, we believe that the recurring nature of Medfly infestations, and the expense of eradication programs, indicates the need for the DFA to report on the programmatic and cost differences between an eradication and control program. The Legislature needs to have this information in order to best decide how to proceed with the program and to evaluate the extent of future General Fund participation in Medfly programs.

Accordingly, we recommend that the DFA submit such a report to the Legislature prior to budget hearings. This report should give an explanation of the scientific reasons for determining whether or not there should be an eradication or control program, the programmatic differences and expected results for each, and details of the costs associated with each program.

LIST OF FINDINGS AND RECOMMENDATIONS

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Crosscutting Issues

California Housing Finance Agency

1. **Proposal to consolidate housing agencies has merit.** G-11
Our analysis indicates that the Governor's proposal has merit, but that merging all *three* state housing agencies would result in greater efficiencies and improved accountability.

Governor's Energy Reorganization Plan

2. **Governor's Energy Reorganization Plan Lacks Detailed Information.** Recommend that Department of Finance provide written information to the Legislature prior to budget hearings which details the elements of the Governor's proposed restructuring. G-17

Department of Consumer Affairs

3. **Keep Athletic Commission Funding Out of General Fund.** We recommend the Legislature fund the State Athletic Commission from fee revenues available to the commission rather than from the General Fund. (Delete Item 1140-001-001 and add Items 1140-001-326 and 1140-001-492.) G-20
4. **Information Required Before Legislature Approves Performance Budgeting.** The DCA's implementing plans should address specific issues before the Legislature approves any performance budget agreement. G-20

Housing and Community Development

5. **Bond-Funded Programs.** The cost of administering the bond-fund programs is exceedingly high. We present a series of options for legislative consideration. G-23
6. **Information Needed on CALDAP Loans.** We recommend that the department report at budget hearings on its estimate of cost to provide CALDAP loans to victims of the Northridge earthquake. G-30
7. **Farm Worker Housing Center Rehabilitation.** Farm workers should share in the cost of rehabilitating farm worker housing communities. We recommend the Legislature adopt Budget Bill Language directing the HCD to increase rents charged to farm workers to pay for a share of the costs of its farm worker community rehabilitation proposal. G-31
8. **Employee Housing Act.** We examine four serious shortcomings in the HCD's and local government enforcement of the Employee Housing Act. We present a series of options for legislative consideration. G-34

Department of Insurance

9. **Conservation and Liquidation Division has Significant Management and Organizational Problems.** Recommend the Legislature review restructuring plan for the division before approving division's budget. G-43
 10. **Expenditures for Conservation and Liquidation Division Have No Meaningful Budget.** Recommend the Legislature add an informational item to the Budget Bill identifying the planned budget-year expenditures from assets under conservatorship. G-46
 11. **Failure to Comply With Supplemental Report Requirement.** The department did not fulfill the 1993 Supplemental Report requirement to report workload measures and standards to the Legislature by December 15, G-47
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| 1993. This report should be submitted to the Legislature prior to hearings on the department's budget. | |
| 12. Proposed Positions for Auto and Workers' Compensation Fraud Program Are Not Justified with Effective Workload Measures. Recommend that the Legislature not approve 100 permanent positions at this time as the department has not allocated resources consistent with workload. | G-47 |
| 13. Establishment of Enforced Conservation Unit Not Justified. Recommend the Legislature delete the proposed \$909,000 appropriation from the Insurance Fund to establish an 11-position unit because the department has not substantiated the need for either the new unit or additional positions. | G-49 |

Trade and Commerce

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| 14. Technology Reinvestment Project Is Focus of Agency's Initial Efforts in Defense Conversion. As of December 3, 1993, the federally funded Technology Reinvestment Project awarded up to \$49 million to defense conversion projects involving state funds. | G-50 |
| 15. Defense Conversion Matching Grant Program. Agency should report to the Legislature on how the grant process will enhance the state's ability to maximize state and federal resources for defense conversion. | G-52 |
| 16. Small Business Loan Guarantee Programs Should be Consolidated. Reduce Item 2920-011-001 by 2.8 million. Delete transfer of \$1.9 million under Item 2920-011-918(b). Reduce Item 2920-001-981 by \$450,000. Recommend the enactment of legislation to transfer the California Export Finance Program to the Small Business Loan Guarantee Program for a single, more efficient state loan guarantee program. | G-55 |
| 17. Information Needed on Surety Bond Program. Recommend that the Legislature not approve the \$ 4.2 million Small Business Expansion Fund appropriation | G-58 |
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	Analysis Page
for support of the Surety Bond Program until it receives and reviews a proposal for this program.	
18. General Fund Support for Permit Streamlining Program Not Justified. Reduce Item 2920-001-001 by \$0.1 million and Item 2920-101-001 by \$1 million. Recommend deletion of \$1.1 million for support of a local permit streamlining program because agency has not justified effective use of the appropriation.	G-58
19. Eliminate Office of California-Mexico Affairs. Reduce Item 2920-001-001 by \$258,000 and eliminate \$1.9 personnel years. Recommend the elimination of the Office of California-Mexico Affairs because the responsibilities of the Office can be assumed by the agency and existing staff.	G-59
20. Reduce General Fund Support for Tourism Program. Reduce Item 2920-001-001 by \$ 3.8 million and increase reimbursements by \$3.8 million. Recommend the Legislature enact legislation to establish a tourism industry fee in order to finance the tourism program.	G-60

Agricultural Labor Relations Board

21. Eliminate the ALRB and Transfer Enforcement of Farm Labor Issues to the PERB. Due to a sharp and persistent decline in the workload of the ALRB Board, we recommend eliminating the ALRB and transfer of the enforcement of farm labor issues to the Public Employment Relations Board.	G-61
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Department of Industrial Relations

22. User Fees Miss Targets. We are concerned about the proposed implementation of DOSH's workplace safety program and recommend that the division report to the Legislature about possible alterations. We withhold recommendation on the \$8.3 million implementation plan pending receipt of information from the DIR.	G-66
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| 23. Require Implementation Reports to Track Reform Implementation. We recommend the department submit reports in 1994, 1995, and 1996 to the Legislature identifying the status of workers' compensation reform implementation. | G-70 |

Department of Food and Agriculture

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| 24. The Agricultural Industry Should Share the Costs of the Medfly Program. We recommend that the Legislature enact legislation authorizing assessment of the agricultural industry for 50 percent of the costs of the Medfly program. To implement this in the budget year, we recommend the Legislature structure 50 percent of the \$17.5 million General Fund appropriation requested in the budget year as a loan to be repaid by January 1, 1995. | G-73 |
| 25. Require the DFA to Report on Medfly Cost Options. We recommend that, prior to budget hearings, the DFA report to the Legislature on the programmatic and cost differences between pest eradication and control efforts. | G-75 |
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