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November 9, 1999

Hon. Bill Lockyer  
Attorney General  
1300 I Street, 17<sup>th</sup> Floor  
Sacramento, California 95814

Attention: Ms. Diane Calkins  
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative relating to the California Veteran Farm and Home Purchase Program (File No. SA 1999 RF 0035, Amendment No. 2-S).

**Background**

*Home Purchase Program.* Since 1921, the California Veteran Farm and Home Purchase Program, known also as the Cal-Vet program, has provided more than 400,000 California veterans the opportunity to buy a farm or home through state assistance. The California Department of Veterans Affairs (DVA), which operates the Cal-Vet program, purchases new and existing homes, farms, and mobile homes that have been selected by an eligible veteran. The state then resells the property in accordance with a contract requiring installment payments by the veteran. In effect, the program operates very much like a conventional home loan program, with participating veterans making monthly payments just like any other borrower on loans of as much as \$250,000 for a single-family home.

As of June 1999, about 33,000 veterans held Cal-Vet loans amounting collectively to about \$2.1 billion. During most of the 1980s, most Cal-Vet loans carried an 8 percent interest rate, but most existing loans now carry an interest rate of 6.95 percent. At the time of this analysis, new loans were available at a rate of 5.95 percent to 6.65 percent, depending upon eligibility requirements.

The program has been funded over its life primarily through the sale of general obligation bonds and revenue bonds, with about \$3.1 billion in outstanding debt as of June 1999. A special revolving fund created by the Veterans Farm and Home Building Act Fund of 1943, also known as the 1943 Act Fund, has been established to facilitate operation of the Cal-Vet program. A portion of the money in the 1943 Act Fund that is not immediately needed for operation of the Cal-Vet loan program is invested in the state treasury and other income-earning bonds and securities.

State law requires that an independent public accounting firm be commissioned each year to conduct a written survey of the financial condition of the division of the DVA that operates the Cal-Vet program. The survey, which is issued each year in the form of a financial audit report, must by law be provided to the Secretary of Veterans Affairs, the California Veterans Board, and a special committee responsible for approving Cal-Vet bond issues.

***Life and Disability Insurance.*** State law authorizes DVA to operate insurance programs in conjunction with the Cal-Vet programs. Veterans participating in the programs are charged premiums to pay for several types of insurance coverage, including a program providing for repayment of the Cal-Vet loan in the event a veteran dies or becomes disabled. As of June 1999, about 28,000 Cal-Vet borrowers were enrolled for life insurance coverage and about 15,500 were enrolled for disability coverage.

A lawsuit filed in June 1996 in Los Angeles County Superior Court, which remains pending, could affect the life and disability insurance program. The lawsuit contends that the state illegally expended about \$71 million in funds that should have been held in reserve for the life and disability insurance program.

At one point in the litigation, the plaintiffs proposed to settle the case with the transfer of \$71 million, plus interest, from within the 1943 Act Fund to a special financial reserve for payment of life and disability insurance. The plaintiffs have also sought to overturn premium increases and limitations on benefits and coverage that were instituted by DVA in the life and disability insurance programs beginning in 1995. The state did not concur in the settlement offer and is denying the allegations made by the plaintiffs in the case.

At the time of this analysis, a date for trial of the case had not been set, and the legal matter was likely to continue in the courts through the end of the year 2000 and perhaps longer.

*Statute of Limitations.* Under state law, most felonies have a statute of limitation of three years, meaning that offenses discovered after that date are not subject to criminal prosecution. State law, however, does not have a statute of limitations for offenses punishable by death or life imprisonment without the possibility of parole, or for the embezzlement of public money.

Also under state law, most civil lawsuits have a statute of limitations of four years, meaning that a lawsuit may not be brought after that period of time to seek compensation for actions which occurred four or more years ago.

## **Proposal**

This measure would amend the California Constitution and statutory law and also presents a series of written statements and allegations regarding the past operation of the Cal-Vet program.

Specifically, the measure directs that the state initiate an audit of the Cal-Vet program and its operating fund commencing within 30 days of the enactment of the initiative and ending by February 1, 2001. The initiative specifies various factual issues that are to be reviewed and determined in the course of that audit, including issues relating to program activities since 1975. Additional audits of the Cal-Vet program with a similar scope would be mandated thereafter every three years. These audits could be conducted by a different auditor, and would differ in scope, from the survey of the financial condition of the Cal-Vet program that is required under existing state law.

This measure requires that certain specified state officials correct problems found by the audit after its completion and release to the public. These corrective steps are to include retroactive restoration of any benefits or funds determined by the audit to have been wrongly diverted from veterans, taxpayers, or the 1943 Act Fund, plus interest and penalties. In particular, based primarily upon the audit results, the measure provides for:

- The transfer of about \$230 million in state funds into a reserve for payment of life and disability insurance benefits, a reduction of life and disability insurance premiums to pre-1996 levels, and reimbursements for certain Cal-Vet borrowers denied life or disability insurance coverage in the past.

- Refunds to Cal-Vet borrowers or the federal government of part of the money earned through the investment of cash held in the 1943 Act Fund.
- A reduction in the current interest rate charged to current Cal-Vet borrowers to the extent that those borrowers were found to have been overcharged by the Cal-Vet program for interest on their loans. Depending upon the audit findings, current and past Cal-Vet borrowers would be entitled to refunds of any amounts they were overcharged on interest on their loans.

***Other Required Actions.*** This measure directs that certain state officials must take further corrective actions in response to the proposed audit, including civil litigation, criminal prosecution, sanctioning of current and past state officials with the loss of retirement benefits, and the dismissal of state officials from their jobs. The measure amends the California Constitution to direct the Governor and Legislature to modify state laws to facilitate the above actions.

The measure further amends the California Constitution to authorize the state Attorney General to pursue civil litigation or criminal prosecution to recover all money or benefits alleged to be owed to veterans, voters, or taxpayers in response to the proposed audit of the Cal-Vet program. Related statutory provisions of this measure direct the Attorney General to investigate specified allegations of wrongdoing and take specified corrective actions in regard to the Cal-Vet program.

### **Fiscal Effect**

This measure would have a number of significant fiscal effects upon state government. The major fiscal effects are discussed below.

***State Agency Implementation Costs.*** This measure would result in significant state costs, potentially as much as several million dollars on a one-time basis, for several state agencies to conduct the audits and investigations and impose the criminal, civil, and administrative sanctions specified in this measure.

The audit proposed in this measure would probably result in significant costs for state government, probably exceeding \$1 million, regardless of the agency selected to conduct the review. The cost of the follow-up audits required by this measure is uncertain and cannot be estimated because their subject and scope would likely be established at a later time.

The costs for the follow-up investigations and sanctions to be undertaken following the initial audit are unknown and cannot be estimated at this time. If the initial audit determined that no wrongdoing occurred, the costs of investigations and sanctions would probably be minor. If the initial audit found wrongdoing did occur, the costs of investigations and sanctions could depend upon the nature of the alleged wrongdoing and the existing statute of limitations for the prosecution of felonies or litigation of civil cases. The measure calls for corrective actions and prosecutions for activities potentially dating back to 1975, while the existing statute of limitations is three years for most felonies and four years for most civil actions.

By law, the statute of limitations would not apply to charges of embezzlement of public money, assuming any such wrongdoing was found. If this were the case, the costs of investigating and imposing criminal, civil, or administrative sanctions could be significant.

***Life and Disability Insurance Programs.*** This measure provides for the transfer of \$230 million to a special reserve fund for future payment of life and disability insurance payments to Cal-Vet borrowers. The measure permits this condition to be met in accordance with the terms of a settlement offer presented by the plaintiffs in the Los Angeles County case, which would have allowed the state to phase in such payments over a five-year period.

The measure does not specify whether the payments would come from the state General Fund or from the assets of the 1943 Act Fund. The settlement offer in the superior court case—which is referenced in the initiative as a means of fulfilling its obligations—specified that the money would come from 1943 Act Fund assets. However, some transfers from the state General Fund could result because of other contractual requirements and financial reserves that were established as a condition of the sale of bonds issued for the Cal-Vet program.

The initiative measure also could result in significant ongoing state costs, potentially in the millions to low tens of millions of dollars annually, by reducing life and disability insurance premiums paid by some Cal-Vet borrowers and overturning changes made by DVA that limited life and disability insurance coverage. Additional costs could result from the provisions in this measure for reimbursements for certain Cal-Vet borrowers denied life or disability insurance coverage in the past. However, it is likely that the \$230 million fund transfer provided by the initiative would establish a sufficient funding reserve for the life and disability insurance program to offset these costs.

*Partial Refund of Investment Profits.* This measure could result in significant state costs by providing for payment to the federal treasury or to Cal-Vet borrowers of part of the profits earned by investments of Cal-Vet program cash between 1975 and 1999. The amount to be paid would depend upon how this provision is interpreted and implemented, but under one possible interpretation could cost the state several tens of millions of dollars on a one-time basis. The measure does not specify whether these payments would come from the state General Fund or from the assets of the 1943 Act Fund, and does not specify any division of the required payments between the federal treasury or Cal-Vet borrowers.

*Interest Rate Reductions and Rebates.* This measure could result in significant state costs to the extent that the required audit of the Cal-Vet program determined that Cal-Vet borrowers had been overcharged on interest payments. These costs, if any, are unknown and cannot be estimated because they would depend upon the findings of the audit.

### Summary of Fiscal Effects

In summary, we conclude that this measure would have an unknown but potentially significant fiscal effect on state government by providing, based primarily upon the results of an audit, for the transfer of about \$230 million to a reserve fund and by potentially resulting in tens of millions of dollars in additional costs. Some of these state costs would be one-time in nature and others would be ongoing.

Sincerely,

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Elizabeth G. Hill  
Legislative Analyst

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B. Timothy Gage  
Director of Finance