TITLE 16. CONTRACTORS STATE LICENSE BOARD
DEPARTMENT OF CONSUMER AFFAIRS

INITIAL STATEMENT OF REASONS

HEARING DATE: September 29, 2020

SUBJECT MATTER OF PROPOSED REGULATION(S): Fees

SECTION(S) AFFECTED: California Code of Regulations (CCR), Title 16, Division 8, Article 1.5, Section 811

Specific Purpose of Each Adoption, Amendment, or Repeal:

1. Problem Being Addressed/Purpose of the Amendment:

The Contractors State License Board's (Board) mission is to protect consumers by regulating the construction industry through policies that promote the health, safety, and general welfare of the public in matters relating to construction. The Board licenses more than 349,000 contractors (active, inactive, and expired but renewable) in 44 different license classifications. Licenses are issued to individuals (sole owners), corporations, partnerships, limited liability companies, and joint ventures. In addition, the Board issues registrations to approximately 31,000 home improvement salespersons (active and expired but renewable) who solicit, sell, negotiate, and execute contracts on behalf of home improvement contractors. As of September 3, 2019, there are approximately 286,694 contractor licensees (active and inactive) and 19,779 home improvement salesperson active registrants.

Business and Professions Code (BPC) section 7008 authorizes the Board to adopt rules and regulations as are reasonably necessary to carry out the provisions of the Contractors State License Law (CSLL). BPC section 7137 authorizes the Board to set fees by regulation to be deposited in the Contractors License Fund (Fund) and made available to the Board upon appropriation by the Legislature. The statute sets forth the minimum and maximum fee ranges for application, examination, initial licensure, license renewal, and other miscellaneous fees. BPC section 7138.1 requires the Board to fix fees "in order to generate revenues sufficient to maintain the Board's fund balance reserve at a level not to exceed approximately six months of annual authorized board expenditures."

The Board's highest priority is consumer protection, and it achieves this important priority by regulating the construction industry through policies that promote the health, safety, and general welfare of the public in matters relating to construction. This includes ensuring applicants meet experience requirements for licensure, investigating complaints against applicants and licensees, and disciplining violators of the CSLL. The Board is a special fund entity, funded entirely by license fees and disciplinary action assessments, and has historically maintained a fund balance reserve of approximately four months of the Board's expenditures. However, over the last two years, the Board expended about $3 million more than its generated revenue.

This deficit is due to a decline in license renewals and over $9 million in unforeseeable expenditures. This has resulted in a structural budget imbalance between revenue and expenditures. If expenditures are not substantially reduced and/or revenue increased, the Board projects insufficient available funds for ongoing operations by July 2020. The Board is unable to redirect resources from other budgeted program areas because resources are not available for this purpose. Without adequate financial resources, the Board will be unable to operate at a capacity that fulfills its highest priority of consumer protection.

The Board needed to take immediate action to increase the regulatory fees it collects. Accordingly, the Board sought and obtained an emergency regulation to increase the renewal fees. The Office of Administrative Law (OAL) approved this emergency rulemaking on December 19, 2019. The Board pursues the instant rulemaking proposal to make the amendments to 16 CCR 811 permanent. These fee increases are necessary to fulfill the Board's priority of consumer protection and the legislative mandates expressed in the applicable statutes.

2. **Anticipated Benefits from this Regulatory Action:**

The proposed amendments to the Board's renewal fee schedule will enable the Board to eliminate a structural budget imbalance, maintain a prudent reserve, and continue the Board's enforcement, investigative, licensing, examination, and public outreach operations. The amendment will ensure that the Board is able to achieve its highest priority of consumer protection.

Factual Basis / Rationale:

Amend section 811

- **Add subd. (a) before "The fee for:"**

This proposal adds "(a)" before "The fee for." The structure of section 811 is not consistent with the established numbering hierarchy for subsections of a regulation. The existing introduction to this section was revised through a Section 100 rulemaking in 2013 (Register 2013, No. 32), and the numbering sequence of the remaining subsections was inadvertently started with a numeric indicator instead of a lower-case letter indicator. Therefore, the Board proposes to add "(a)" in front of the first sentence of the section to reestablish the correct subsection numbering hierarchy for the regulation.

- **Amend section 811(a)(7), as newly renumbered in this proposal**

This proposal would delete “360” and add “450” to increase the renewal fee for the active contractor license to the statutory limit of $450, as allowed by BPC section 7137(e)(1). The purpose of the amendment is to permanently increase the renewal fee for an active license to the statutory maximum to address Board’s structural budget imbalance.

- **Amend section 811(a)(8), as newly renumbered in this proposal**

This proposal would delete “180” and add “225” to increase the renewal fee for an inactive contractor license to the statutory limit of $225, as allowed by BPC section 7137(e)(2). The purpose of the amendment is to permanently increase the renewal fee for an inactive license to the statutory maximum to address the Board’s structural budget imbalance.

- **Amend section 811(a)(11), as newly renumbered in this proposal**

This proposal would delete “75” and add “95” to increase the renewal fee for a home improvement salesperson registration to the statutory limit of $95, as allowed by BPC section 7137(h). The purpose of the amendment is to permanently increase the renewal fee for a home improvement salesperson registration to the statutory maximum to address the Board’s structural budget imbalance.

<u>Necessity:</u>

In 2017, the Legislature amended BPC Code section 7137 (Senate Bill 1039, Stats of 2016, Ch. 799), which authorized the Board to implement at least a 10 percent fee increase for all statutory fees listed in section 7137. The statute expressly authorized increases to the fees for renewal of an active license, renewal of an inactive license, and renewal of a home improvement salesperson registration. (Bus. & Prof. Code, § 7137, subds. (e)(1), (e)(2), and (h).) Through this amendment, the Board proposes to increase these fees to their statutorily authorized maximums. The Board will be pursuing a separate rulemaking proposal to increase the remainder of the fees set forth in BPC section 7137 after the Board completes a fee study.

This rulemaking is necessary to permanently increase renewal fees to avoid the imminent shutdown of CSLB’s enforcement activity, the impending insolvency of the Board, and serious harm to the public and their property. The Board is experiencing reduced license renewals, significantly increased expenditures, a structural budget imbalance, and a rapidly shrinking fund balance reserve. These factors will immediately impact the Board’s ability to continue its enforcement efforts and severely limit the performance of its core licensing, examination, investigative, and public outreach functions.

Factors beyond the Board's control have increased Board expenditures while not adequately increasing revenue. Current fiscal year (FY) 2019-20 projections show that the Board will over-expend its appropriated resources if it does not curtail major and critical consumer protection programs like enforcement. This imbalance will require the Board to cease all disciplinary case proceedings as soon as July 2020, once it has expended its appropriation for those expenditures. By ceasing disciplinary proceedings, the Board will be unable to refer cases to the Attorney General's (AG) office for discipline.

These cases include the most egregious violations of the CSLL that lead to license suspensions, probation, and license revocations. The Board would be forced to cancel all denial and disciplinary hearings with the Office of Administrative Hearings (OAH) that are scheduled months in advance, which will delay the adjudication of the most serious cases of consumer harm and property damage and allow dangerous contractors to continue contracting.

The Board requires a sufficient fund balance to ensure that it can fulfill monthly financial obligations such as salaries, rent, and AG/OAH charges, and pay for unexpected costs. The Board also regularly experiences uneven cash flow patterns. It is frequently required to spend significantly more in one month than its revenue on hand in that same month. Accordingly, if the Board does not raise renewal fees immediately, it risks being unable to pay for expenditures that exceed its current fund balance.

The chart below illustrates the type of revenue fluctuations the Board has experienced in the last fiscal year.

Monthly Revenue FY 2018-19

Jul	Aug	Sep	Oct	Nov	Dec
$4,769,425	$8,277,313	$5,170,667	$5,883,272	$4,459,043	$4,847,164

Jan	Feb	Mar	Apr	May	Jun
$5,623,064	$5,672,032	$5,898,228	$5,502,682	$5,238,177	$4,578,674

The Board projects that, given expected revenue and expenses, it will end its current fiscal year with 0.3 months in reserve. This equates to only a $2 million cushion for unforeseen expenditures. As the chart shows, the Board experienced month-to-month revenue fluctuations last fiscal year from approximately $4.5 million to $8.3 million. If these revenue drops were to occur in consecutive months in FY 2019-20, the Board's entire budget reserve would be nearly exhausted, and it would risk not being able to pay its bills.

Additionally, the Board's expenditures are subject to significant month-to-month fluctuation. The charts below show the Board's AG and OAH monthly costs for FY 2018-19.

Monthly AG Costs FY 2018-19

Jul	Aug	Sep	Oct	Nov	Dec
$417,310	$511,633	$392,227	$544,252	$438,666	$406,698

Jan	Feb	Mar	Apr	May	Jun
$570,831	$472,759	$509,350	$499,740	$546,400	$599,590

Monthly OAH Costs FY 2018-19

Jul	Aug	Sep	Oct	Nov	Dec
$85,750	$97,444	$92,960	$93,990	$93,810	$106,330

Jan	Feb	Mar	Apr	May	Jun
$133,862	$103,180	$142,695	$123,830	$136,080	$99,330

As shown in the above charts, the Board experienced month-to-month cost fluctuations last fiscal year from $392,227 to $599,590 in AG costs, and $85,750 to $142,695 in OAH costs. Moreover, the AG announced on July 12, 2019, that its costs would increase beginning September 1, 2019. The AG raised its hourly rates for Deputy AG services from $170 per hour to $220 per hour and raised the fees for paralegal services from $120 per hour to $205 per hour. An AG cost increase of $50,000 in one month at the former rate of $170 per hour would now equate to a cost increase of more than $64,700 at the AG's new $220 rate.

Furthermore, the Board suffered an unexpected litigation cost ($950,000) in the last year that put additional fiscal pressures on the Board's budget. This shows that even one litigation matter can cause instability in the Board's budget and threaten its core mission of consumer protection.

Again, if the Board were to experience the same substantial cost increases that it previously experienced in consecutive months, or in combination with a low revenue month, or if other unexpected costs arise, the Board's current budget reserve would be depleted, it could not pay its bills, and the Board would need to immediately cease enforcement activity and paying for other critical expenses.

Based on projected levels of revenue and expenditures, the deficit between revenue and expenditures will continue to grow (i.e., structural budget imbalance). Below is an analysis of the Board's actual and estimated structural budget imbalance, where expenditures exceed revenue, documenting from

FY 2016-17 to FY 2021-22 the levels of revenue, expenditures with any reimbursements, the difference between the two, and the number of months in reserve.

- For FY 2016-17, the revenue was $60,078,000 and expenditures were $62,867,000, equaling a difference and structural budget imbalance of negative $2,789,000 and leaving a reserve of 2.7 months.
- For FY 2017-18, the revenue was $65,627,000 and expenditures were $67,937,000, equaling a difference and structural budget imbalance of negative $2,310,000 and leaving a reserve of 2.3 months.
- For FY 2018-19, the revenue was $65,920,000 and expenditures were $71,890,000, equaling a difference and structural budget imbalance of negative $5,970,000 and leaving a reserve of 1.3 months.
- For FY 2019-20, the revenue is projected to be $67,070,000 and expenditures are projected to be $73,106,000, equaling a difference and structural budget imbalance of negative $6,036,000 and leaving a reserve of 0.3 months.
- For FY 2020-21, the revenue is projected to be $66,208,000 and expenditures are projected to be $75,334,000, equaling a difference and structural budget imbalance of negative $9,126,000, which is a reserve of negative 1.1 months.
- For FY 2021-22, the revenue is projected to be $67,535,000 and expenditures are projected to be $77,633,000, equaling a difference and structural budget imbalance of negative $10,098,000, which is a reserve of negative 2.6 months.

Since July 2017, the Board's costs have increased significantly (more than $9 million) and most, if not all, were unforeseeable and/or nonexistent at the time the Legislature authorized the Board to increase its fees to the current statutory caps. The following is an analysis of the Board expenditures over the last three fiscal years and the projected figures for FY 2019-20, broken down into several categories.

- For FY 2016-17, the total expenditures were $63,473,443, broken down to $34,233,961 for personnel services, $19,378,375 for operating expenses, $6,656,107 for enforcement, and $3,205,000 for external costs (e.g., statewide pro rata, pension payments, Fi$Cal).
- For FY 2017-18, the total expenditures were $68,651,631, broken down to $36,219,316 for personnel services, $21,461,080 for operating expenses, $7,010,235 for enforcement, and $3,961,000 for external costs (e.g., statewide pro rata, pension payments, Fi$Cal).

- For FY 2018-19, the projected total expenditures are $72,550,000, broken down to $39,500,000 for personnel services, $20,285,000 for operating expenses, $8,000,000 for enforcement, and $4,765,000 for external costs (e.g., statewide pro rata, pension payments, Fi$Cal).
- For FY 2019-20, the projected total expenditures are $73,459,000, broken down to $42,577,000 for personnel services, $16,162,000 for operating expenses, $9,169,000 for enforcement, and $5,451,000 for external costs (e.g., statewide pro rata, pension payments, Fi$Cal). These projections represent a 1% increase over FY 2018-19.

Of the $9 million increase in costs since FY 2016-17, the most significant operational increases occurred in the following areas:

- $5.2 million in personnel services (e.g., increased staffing, salary, benefits, pay raises, retirements).
- $1.5 million in external state operation costs (e.g., statewide pro rata, pension payments, Fi$Cal). These costs are beyond the Board's control and are imposed statewide by various control agencies as mandatory charges that funds must absorb.
- $1.3 million (approximately) in enforcement (e.g., AG's Office and OAH).
- $1 million (approximately) in operating expenses.

Since FY 2013-14, costs beyond the Board's control have increased significantly in the following areas:

- $11.5 million in personnel services (e.g., increased staffing, salary, benefits, pay raises, retirements). On average, this increases by $3 million annually.
- $3 million in external direct costs (e.g., statewide pro rata, pension payments, Fi$Cal) that are beyond the Board's control and are issued statewide by various control agencies as mandatory charges that funds must absorb.
- The Board has devoted resources to the many disasters throughout the state (e.g., wildfires and mudslides), which has contributed to an increase in operational costs (e.g., travel reimbursements, vehicle costs, overtime). On average, this has been an increase of $500,000 in costs annually and will continue indefinitely. (Personnel Services and Operating Expenses)
- As of June 2019, the Board is seeing a 3% decline (roughly 4,000) in license renewals, which equates to a revenue loss of about $2 million. Since renewals constitute the main source of revenue for the Board (on average 75%), this decline is extremely concerning.

The Board's expenditure projections for FY 2019-20 and ongoing future costs include the following:

- $3 million more annually in personnel services to fund future collective bargaining unit agreements for increases to salaries and benefits.
- $1 million more annually in Department of Technology costs as CSLB increases online application submittals and to fund necessary information technology support and security.

Based on the above analysis, the Board has a structural budget imbalance due to revenue loss and increased costs and is using its reserve faster than anticipated. By July 2020, the Board will have insufficient funds for ongoing operations if costs continue to increase and revenue continues to underperform, without cutbacks or fee increases.

The Board proposes to increase renewal fees only because it has not conducted a desk audit or study to justify increasing any other fees. Therefore, the fees listed in Table 1 below are the only fees the Board proposes to increase at this time. The Board proposes to increase these fees to their statutory maximums pursuant to BPC section 7137.

Table 1. Fee Schedule

Renewal Type	Current Fee Amount in CCR §811	Current Minimum Statutory Fee Per BPC §7137	New Fee Statutory Maximum Per BPC §7137	Fee Increase Amount
Biennial Renewal – Active Contractor License	$360	$400	$450	$50
Quadrennial Renewal – Inactive Contractor License	$180	$200	$225	$25
Biennial Renewal – Home Improvement Salesperson Registration	$75	$83	$95	$12

Fund Condition Statements:

With this regulation proposal, the Board is providing two Fund Condition Statements (Contractors License Fund) as follows:

1. Projected Budget – Status Quo Fund Condition – fee increase approved by emergency regulation on December 19, 2019, effective January 1, 2020.
2. Projected Budget – Projected Fund condition with permanent fee increase, effective June 1, 2020.

The Status Quo Fund Condition without a fee increase reflects the current status of the Board's Fund Condition and the need for immediate additional revenue. The Projected Fund Condition with permanent renewal fee increases reflects a scenario by which the Board would actualize revenue from a permanent fee increase and eliminate its current structural imbalance to maintain a healthy fund balance reserve.

UNDERLYING DATA:

The Board relied upon the following documents for this proposal:

1. August 5, 2019 CSLB Executive Committee Summary Report
2. Staff Budget Overview Report from September 24, 2019 Board Meeting
3. Excerpt from Draft September 24, 2019 Board Meeting Minutes
4. Fund Condition Statements (Contractors License Fund):
    - Projected Budget – Status Quo Fund Condition – No fee increase
    - Projected Budget – Proposed Fund Condition – Permanent fee increase effective June 1, 2020.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS:

This regulation may have an economic impact on businesses, specifically, contractor licensees and home improvement salesperson registrants. The Board issues licenses to sole owners, corporations, partnerships, limited liability companies, and joint ventures. The regulation would impose additional fees on the renewal of contractor licenses and home improvement salesperson registrations, which are paid every two years for active licenses or every four years for inactive licenses. To the extent these licensees opt to renew their licenses and registrations, the proposed regulations will impact them. Although the regulation has an economic impact, the impact is not anticipated to be significant because the fee increase is considered to be very minor compared to the income of most licensees and registrants.

Specific average ongoing annual licensee and registrant cost impacts are shown in the table below:

Cost Impact – Contractor Licensee Businesses

Revenue Category	Approximate Annual Population	Fee Increase Amount Per Each	Total Average Annual Revenue Increase
Biennial Renewal – Active Contractor License	115,946*	$50	$5,797,300
Quadrennial Renewal – Inactive Contractor License	13,700**	$25	$342,500
Biennial Renewal – Home Improvement Salesperson Registration	9,890	$12	$118,680
		TOTAL:	**$6,258,480**

** Approximately 58.5% of active licensees are sole owners*
*** Approximately 90.5% of inactive licensees are sole owners*

<u>ECONOMIC IMPACT ASSESSMENT:</u>

This regulatory proposal is needed to take immediate action to increase the regulatory fees it collects per BPC section 7138.1. This authority requires the Board to “fix fees” in order to generate revenues sufficient to maintain the Board’s fund balance reserve at a level not to exceed approximately six months of annual authorized board expenditures. Also, the Board filed an emergency action to solve this serious funding issue and structural budget imbalance with OAL that was approved on December 19, 2019. This regulatory action will make amendments to 16 CCR 811 permanent. These fee increases are necessary to fulfill the Board’s priority of consumer protection and the legislative mandates expressed in the applicable statutes. Moreover, based on the analysis under the “Evidence Supporting Finding of No Significant Statewide Adverse Economic Impact Directly Affecting Business,” the Board concluded the following:

- It will not result in the creation of new jobs or elimination of jobs within the state of California because the proposed fees are anticipated to have minimal impact on businesses.
- It will not result in the creation of new businesses or elimination of businesses within California the proposed fees are anticipated to have minimal impact on businesses.
- It will not affect the expansion of businesses currently doing business within the State of California because the proposed fees are anticipated to have minimal impact on businesses.

- It will benefit the health and welfare of California residents because the proposal will increase the Board's revenue and funding available to continue uninterrupted the Board's enforcement, investigative, licensing, examination, and public outreach operations.
- It will not affect worker safety because the proposal does not relate to worker safety.
- It will not affect the State's environment because the proposal does not relate to environmental issues.

REQUIREMENTS FOR SPECIFIC TECHNOLOGIES OR EQUIPMENT:

These regulations do not mandate the use of specific technologies or equipment.

CONSIDERATION OF ALTERNATIVES:

No reasonable alternative to the regulatory proposal would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

No alternatives were considered because CSLB's Fund will become insolvent in the near future without a fee increase. If CSLB reduces its annual expenditures to mitigate the structural fund imbalance, CSLB would be forced to cut mission critical functions, which will jeopardize the public safety of California consumers.

FISCAL IMPACT ASSESSMENT:

The Board indicates any workload and costs related to implementing the proposed regulations will be absorbed within existing resources.

The Board estimates the proposed regulations will increase revenues by approximately $6.26 million per year, eliminate any structural imbalance, and begin to build a prudent fund balance reserve.