**TITLE 16. PROFESSIONAL AND VOCATIONAL REGULATIONS**

**DIVISION 8: CONTRACTORS STATE LICENSE BOARD**

# FINDING OF EMERGENCY

**SUBJECT MATTER OF PROPOSED REGULATIONS:** Fees

**SECTION AFFECTED:** Title 16, Division 8, California Code of Regulations Section 811

**SPECIFIC FACTS SHOWING THE NEED FOR IMMEDIATE ACTION:**

The filing of this emergency rulemaking is necessary to avoid the imminent shutdown of the Contractors State License Board's (Board) enforcement activity, the impending insolvency of the Board, and the resulting serious harm to the public and their property. The Board is experiencing reduced license renewals, significantly increased expenditures, a structural budget imbalance (between revenue and expenditures), and a rapidly declining Contingent Fund (i.e., "savings account") that 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.

Due to factors beyond the Board's control that have increased Board expenditures while not adequately increasing revenue, the Board's core mission of consumer protection is threatened. Current fiscal year (FY) 2019-20 projections indicate that the Board will over-expend its appropriated resources if major and critical consumer protection programs, such as enforcement, are not curtailed. Ultimately, this would lead to the Board ceasing 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 forward cases to the Attorney General's office for discipline, which include the most egregious violations of the Contractors' State License Law that lead to license suspensions, probation, and license revocations. The Board will further be forced to cancel all denial and disciplinary hearings with the Office of Administrative Hearings that are scheduled months in advance, thus delaying the adjudication of the most serious cases of consumer harm and property damage and allowing dangerous contractors to continue contracting.

This emergency rulemaking to increase the Board's regulatory fee schedule will increase revenue to ensure that the Board complies with its mandated and prudential Fund Condition reserves, to allow it to request additional spending authority for enforcement activities, and to maintain the Board's solvency.

In 2017, Business and Professions Code section 7137 was amended, which authorized the Board to implement at least a 10 percent fee increase for all statutory fees listed in Section 7137 that was expected to increase revenue by $5 million annually, providing the Board a healthy and stable fund. However, over the last two years, the Board has unexpectedly seen a revenue loss due to a decline in license renewals and unforeseeable expenditures related to employee compensation, external direct charges, and disaster response creating a structural budget imbalance, which is rapidly depleting the Board's reserve. Based on the decline in revenue and increased expenditures, the

Board projects insufficient available funds for ongoing operations by the beginning of FY 2020-21 if expenditures are not substantially reduced and funds increased.

Because of these abrupt changes in Board revenue and expenditures and the resultant inadequate funding and imminent insolvency, the Board is unable to file regulations through the regular rulemaking process as they are anticipated to take 12 to 24 months to become effective.

**Background:**

The Board's 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.

Pursuant to Business and Professions Code section 7000.6, protection of the public is the Board's highest priority in exercising its licensing, regulatory, and investigative and disciplinary functions. Business and Professions Code section 7008 authorizes the Board to adopt rules and regulations in accordance with the Administrative Procedure Act that are reasonably necessary to carry out the provisions of the Contractors' State License Law. Business and Professions Code section 7138.1 mandates, "the board shall fix fees to be collected pursuant to that section in order to generate revenues sufficient to maintain the board's reserve fund at a level not to exceed approximately six months of annual authorized board expenditures." The Board has historically maintained a budget reserve of approximately four months of the Board's expenditures. The proposed amendments are necessary to carry out the Board's mission and the legislative mandates expressed in the applicable statutes.

In 2010, the Board promulgated regulations that increased its fees to the statutory maximums allowed at the time under Business and Professions Code section 7137. Those changes became effective July 1, 2011 and are the amounts currently reflected in Title 16, California Code of Regulations section 811.

Through Senate Bill 1039 (Stats of 2016, Ch. 799), the Legislature increased the Board's fees to their current statutory levels, setting many of the fees in statute and including the authority for the Board to increase the fees to their designated statutory maximums through regulatory action.

**Budget Overview:**

The Board is a special fund entity, funded entirely by license fees and disciplinary action assessments. However, over the last two years, the Board expended about $3 million more than the revenue brought in. In addition, the Board has seen an unexpected revenue loss due to a decline in license renewals and over $9 million in unforeseeable expenditures, creating a structural budget imbalance. Based on the decline in revenue and increased expenditures, the Board projects insufficient available funds for ongoing operations by July 2020 if expenditures are not substantially reduced and/or funds increased.

However, the Board may run out of funds sooner than July 2020 if monthly financial obligations increase or revenue decreases unexpectedly. The Board requires a sufficient fund balance to ensure that it can fulfill monthly financial obligations such as salaries, rent, and Attorney General/Office of Administrative Hearings 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 the 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, which 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 $8.3 million to $4.5 million, which is a revenue decrease of approximately $3.8 million in only a couple of months. If such revenue drops were to occur in consecutive months in FY 2019-20, the Board's entire budget reserve would be nearly exhausted, and it risks 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 Attorney General (AG) and Office of Administrative Hearing (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 will increase beginning September 1, 2019. The AG raised its hourly rates for Deputy Attorney General 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.

**Structural Budget Imbalance:**

Based on projected levels of revenue and expenditures, the deficit between revenue and expenditures will continue to grow (i.e., structural budget imbalance). The following 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 issued statewide by various control agencies as mandatory charges that funds must absorb.
- $1.3 million (approximately) in enforcement (e.g., Attorney General's Office and Office of Administrative Hearings).
- $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 the Board increases online application submittals and to fund necessary information technology support and security.

Based on the above analysis, the Board is in a structural budget imbalance due to revenue loss and increased costs and is using the 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 a fee increase.

Due to the abrupt changes in Board revenue and expenditures and the resultant inadequate funding and imminent insolvency, the Board is unable to file regulations through the regular rulemaking process to resolve the structural imbalance in time to avert a shutdown of critical operations as regular regulations are anticipated to take 12 to 24 months to process before they become effective. Therefore, at this time, the Board is seeking to address the Board's structural budget imbalance through this emergency rulemaking proposal.

**<u>Fund Condition Statements:</u>**

With this emergency regulation proposal, the Board is providing two Fund Condition Statements as follows:

1. Projected Budget – Status Quo Fund Condition – no fee increases with updated FY 2019-20 revenue estimate that displays lower renewal revenue
2. Projected Budget – Projected Fund Condition with emergency renewal fee increases – upon approval of emergency regulations (projected effective date of January 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 emergency renewal fee increases reflects a scenario by which the Board would actualize revenue from an emergency fee increase and eliminate its current structural imbalance to maintain a healthy reserve in its Contingent Fund.

**INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW:**

Amend California Code of Regulations, Title 16, Division 8, Article 1.5, Section 811.

Existing laws authorize the Board to charge fees for various applications, examinations, initial licensure, license renewals, and other miscellaneous fees. The Board is a self-supporting, special fund agency that generates the majority of its revenue from renewal fees (on average 75%).

In addition, the renewal fees alone were selected for increase because no desk audit or study has been conducted yet to justify increasing any other fees; therefore, the fees listed in Table 1 below are the only fees proposed to be increased at this time. The Board is proposing to increase these fees to their statutory maximums pursuant to Business and Professions Code section 7137.

The Board is adding "(a)" to the beginning of the first line of the section to re-establish the correct numbering hierarchy for this section of law, which was inadvertently deleted in a previous Section 100 rulemaking action in 2013.

In addition, the Board is proposing to increase renewal fees as detailed in Table 1 below.

**Table 1. Fee Schedule**

| Renewal Type | Current Fee Amount in CCR §811 | Current Minimum Statutory Fee Per BPC §7137 | New Fee | 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 |

These emergency regulations will take effect upon approval by the Office of Administrative Law.

After conducting a review for any regulations that would relate to or affect this area, the Board evaluated this regulatory proposal and found it is not inconsistent or incompatible with existing regulations.

## PURPOSE, ANTICIPATED BENEFIT, AND RATIONALE:

The Board's highest priority is consumer protection. The Board 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, including ensuring applicants meet experience requirements for licensure, investigating complaints against applicants and licensees, and disciplining violators of the Contractors' State License Law. The Board is fully funded by application and licensing fees. Therefore, without adequate financial resources, the Board is unable to operate at a capacity that fulfills its highest priority of consumer protection.

Due to recent declines in license renewals and increases in expenditures, the Board's Contingent Fund is currently in jeopardy of falling into insolvency. The Board is unable to redirect resources from other budgeted program areas as resources are not available for this purpose.

Immediate action to increase the regulatory fees collected by the Board is required. The Board has determined that this regulatory proposal will have the following benefits on the health and welfare of California residents, consumers, contractor licensees, and home improvement salesperson registrants. The increased fees will increase the Board's revenue and funding available to continue the uninterrupted enforcement, investigative, licensing, examination, and public outreach operations of the Board.

The filing and emergency approval of these proposed regulations to increase regulatory fees will provide the Board with resources necessary to fund its operations and fulfill its mission of consumer protection. Filing proposed regulations through the regular rulemaking process is anticipated to take 12 to 24 months to effectuate and would then only begin generating additional needed revenue, which would require the Board to restrict its core operations including slowing its ability to process applications, curtail investigations, and limit the Board's ability to adjudicate violations of the Contractors' State License Law in an expedient manner. This restriction to the operational functions of the Board would threaten the Board's ability to achieve its mission and statutory mandate of consumer protection and would place the public in jeopardy of being harmed by allowing dangerous practitioners to continue contracting.

## 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:
    - Projected Budget – Status Quo Fund Condition – No fee increase
    - Projected Budget – Proposed Fund Condition – Fee increase effective January 1, 2020

## AUTHORITY AND REFERENCE:

Pursuant to the authority vested by Section 7008 of the Business and Professions Code, and to implement, interpret, or make specific Sections 7076.5 and 7137 of said Code, the Board is proposing changes to Section 811 of Article 1.5 of Division 8 of Title 16 of the California Code of Regulations.

## FISCAL IMPACT ESTIMATES:

Fiscal Impact on Public Agencies Including Costs or Savings to State Agencies or Costs/Savings in Federal Funding to the State: The anticipated average additional revenue from the proposed fee increase will increase the Board's revenue by approximately $6,258,480 additional revenue per fiscal year ongoing ($6,139,800 for contractor license renewals and $118,680 for home improvement salesperson registration renewals, as shown in Tables 2 and 3 below).

Nondiscretionary Costs/Savings to Local Agencies: None

Local Mandate: None

Cost to Any Local Agency or School District for Which Government Code Sections 17500 – 17630 Require Reimbursement: None

Business Impact: 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.

Specific average ongoing annual licensee and registrant cost impacts are shown in Table 2 below:

**Table 2. 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*

Impact on Jobs/New Businesses: The Board has determined that this regulatory proposal will not have a significant impact on the creation of jobs or new businesses or the elimination of jobs or existing businesses or the expansion of businesses in the State of California because the proposed fees are anticipated to have a minimal impact on businesses.

Cost Impact of Representative Private Person or Business: This regulation may have an economic impact on private persons or businesses, specifically, sole owner contractor licensees and home improvement salesperson registrants. The regulation would impose additional fees on the renewal of contractor licenses, which are paid every two years for active licenses or every four years for inactive licenses and on the renewal of home improvement salesperson registrants, which are paid every two years. To the extent these licensees opt to renew their licenses and registrations, the proposed regulations will impact them.

Specific average ongoing annual sole owner contractor licensee and home improvement salesperson registrant cost impacts are shown in Table 3 below:

**Table 3. Cost Impact – Sole Owner Contractor Licensees and Home Improvement Salesperson Registrants**

| Revenue Category | Approximate Annual Population | Fee Increase Amount Per Each | Total Average Annual Revenue Increase |
|---|---|---|---|
| Biennial Renewal – Active Contractor License | 67,886* | $50 | $3,394,300* |
| Quadrennial Renewal – Inactive Contractor License | 12,403* | $25 | $310,075* |
| Biennial Renewal – Home Improvement Salesperson Registration | 9,890 | $12 | $118,680 |
| | | **TOTAL:** | **$3,823,055** |

** This represents a subset of the contractor license populations and revenue identified in Table 2 above.*

Effect on Housing Costs: None