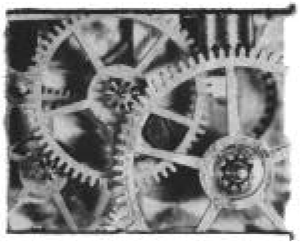

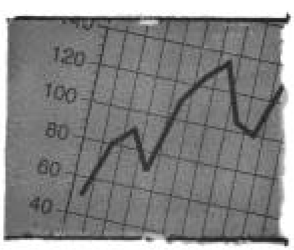

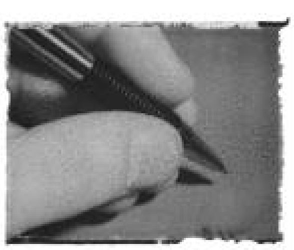

ANALYSIS OF THE NEW JERSEY BUDGET

DEPARTMENT OF THE TREASURY

FISCAL YEAR 2004 - 2005

PREPARED BY OFFICE OF LEGISLATIVE SERVICES
NEW JERSEY LEGISLATURE • MAY 2004

NEW JERSEY STATE LEGISLATURE

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This report was prepared by the Revenue, Finance and Appropriations Section of the Office of Legislative Services in conjunction with the Legislative Budget and Finance Office. The primary authors were Catherine Z. Brennan and Donald S. Margeson with additional contributions by Thomas Koenig.

Questions or comments may be directed to the OLS Revenue, Finance and Appropriations Section (609-984-6798) or the Legislative Budget and Finance Office (609-292-8030).

DEPARTMENT OF THE TREASURY

Budget Pages....... C-17; C-26; C-34; D-391- to D-438; E-11 to E-13; and G-5 to G-12

Fiscal Summary ($000)

	Expended FY 2003	Adjusted Appropriation FY 2004	Recommended FY 2005	Percent Change 2004-05
State Budgeted	$2,520,116	$2,274,778	$2,300,775	1.1%
Federal Funds	4,161	4,076	5,638	38.3%
Other	1,038,583	1,096,742	1,085,682	(1.0)%
Grand Total	$3,562,860	$3,375,596	$3,392,095	0.5%

Personnel Summary - Positions By Funding Source

	Actual FY 2003	Revised FY 2004	Funded FY 2005	Percent Change 2004-05
State	4,532	4,604	4,908	6.6%
Federal	13	16	22	37.5%
Other	1,663	1,728	1,784	3.2%
Total Positions	6,208	6,348	6,714	5.8%

FY 2003 (as of December) and revised FY 2004 (as of September) personnel data reflect actual payroll counts. FY 2005 data reflect the number of positions funded.

Introduction

The Department of the Treasury is the central management agency of State government. It has major responsibilities in guiding the direction of State operations through its planning, management and budget components; in securing the State's financial interests through the collection of taxes and other revenues and the investment of State assets; and in the distribution of significant amounts of State aid and grants to individuals, local governments and universities. In addition, the department provides statewide support services to other agencies in the form of computer services, employee benefits management, purchasing goods and services, maintaining and leasing facilities, operating a State vehicle fleet, and providing mail and printing services.

The FY 2005 budget includes a number of agencies considered "in but not of" the Department of the Treasury. Three of these agencies, the **Board of Public Utilities**, the **Casino**

Key Points

Control Commission and the Office of Information Technology, have been associated with the department for a number of years. Other organizations such as the Ratepayer Advocate, the Higher Education Student Assistance Authority (HESAA, formerly the Higher Education Assistance Authority), and the Educational Facilities Authority (EFA) were reassigned to the department several years ago when the Department of the Public Advocate and the Department of Higher Education were eliminated.

A number of agencies were reassigned to the department in FY 1999. These organizations include the N.J. Commerce and Economic Growth Commission, the N.J. Commission on Science and Technology, the N.J. Economic Development Authority, the Office of Administrative Law, the Office of the Public Defender and the Office of Legal Services.

In order to be consistent with the data as it is displayed in the Governor's budget, the funding and position data in the Department of the Treasury for Higher Educational Services, the N.J. Commerce and Economic Growth Commission, the Economic Planning and Development Statewide program and the N.J. Commission on Science and Technology are included in the above tables as well as in the overview section below. Other explanatory data for the above agencies are not included in this analysis but are contained in two separate analyses that are related to the above programs: "Higher Educational Services" and the "New Jersey Commerce and Economic Growth Commission and Related Economic Development Programs."

Key Points

OVERVIEW

- The Governor has recommended $3.4 billion in total resources that the Department of the Treasury will either use for its own operations or distribute to individuals, colleges or municipalities in FY 2005. This amount represents an increase in resources of less than one percent from the current year.

- The Governor has recommended $2.3 billion in State budgeted resources (General Fund, Property Tax Relief Fund and Casino Control Fund) for the Department of the Treasury in FY 2005, an increase of 1.1 percent from the FY 2004 adjusted appropriation.

- The Governor has recommended $5.6 million in Federal Funds for the Department of the Treasury for FY 2005, a 38 percent increase from FY2004. These funds are for programs administered by the Board of Public Utilities, the Office of the Public Defender, and Legal Services of New Jersey.

- The Governor has recommended $1.1 billion in Other Funds for FY 2004, a 1.0 percent decrease from FY 2004. Other Funds represent non-budgeted or "off-budget" revenues such as taxes collected at the State level and distributed to local governments, special revenue funds and revolving funds. Included in the recommended amounts are proposed distributions of $787.7 million in energy tax receipts and $98.2 million in revolving funds for the Office of Information Technology (OIT).

- The recommended General Fund appropriation for the Department of the Treasury is $1.2 billion, a net increase of 1.8 percent. The Governor's Budget includes increases in three

Key Points

categories of General Fund appropriations: Grants-in-Aid (increased by $17 million or 8.1 percent), State Aid (increased by $16.5 million or 6.2 percent), and Debt Service (increased by $6.8 million or 1.8 percent). These increases are offset by a recommended reduction in the department's Direct State Services appropriation (decreased $18.9 million or 5.1 percent). (The Governor's Budget does not include any funding for Capital Construction in FY 2005.)

- Although the Governor's Budget has recommended a decrease in funding for General Fund-Direct State Services from the current year adjusted appropriation of $370 million to $352 million in FY 2005, the Governor's Budget historically has included language that appropriates to the department additional (supplemental) funds for a number of programs without further legislative action.

ECONOMIC REGULATION

- The Governor's Budget recommends a Direct State Services appropriation of $28.8 million for the Economic Regulation Program, a reduction of $215,000 (or 1 percent) from the current year. This program class includes the Board of Public Utilities (BPU), budgeted at $22.9 million, and the Ratepayer Advocacy Program, budgeted at $5.9 million; both are funded by assessments levied on various utilities conducting business within the State. The decrease in funding for this program represents unspecified "operating efficiencies."

- Proposed language would permit the BPU to supplement its $22.9 million recommended appropriation by up to $3 million from revenues derived from fines, penalties and settlements imposed upon utilities for various violations. If approved, this language would allow the BPU to operate without increasing its industry assessment. Absent this language, the revenues from fines and penalties imposed upon the industry would otherwise accrue to the General Fund.

- Grants-in-Aid funding for the "Lifeline Credit Program," and the Tenants' Lifeline Assistance Program is recommended to remain unchanged at $70.8 million for FY 2005. These two statutorily established programs provide energy assistance grants to senior citizens and the disabled and are funded through an assessment on energy bills. Although the BPU provides funding for these programs through the Universal Service Fund (into which assessment revenues are deposited), the Department of Health and Senior Services is responsible for administration of these grants.

GOVERNMENTAL REVIEW AND OVERSIGHT

- The Governor's Budget recommends a relatively flat $20 million for the Governmental Review and Oversight program, of which $19.5 million is appropriated to the Office of Management and Budget (OMB) and $555,000 is appropriated for Employee Relations and Collective Negotiations. A less than one percent reduction ($101,000) is recommended for OMB attributable to the redeployment of position control staff.

FINANCIAL ADMINISTRATION

- The amount recommended in FY 2005 for Taxation Services and Administration (Division of Taxation) from State funds is $88.2 million, $3.7 million (4 percent) less than the FY

Key Points

2004 adjusted appropriation. This net decrease reflects the elimination of $4.8 million in supplemental funding for debt collection services contracts, plus savings of $825,000 from a "forms reduction initiative" available because of the increase in alternative (electronic) tax filings. These reductions are partially offset by recommended increases for the division attributable to the hiring of additional tax auditors ($554,000) and the inclusion of a special purpose appropriation($1.175 million) for the Property Assessment Management System (PAMS) to revise the division's program for aggregating and analyzing local real property data that the State, county tax boards and municipal assessors use to generate tax lists, assessments, and various reports.

- A sum of $27.8 million in State funding is recommended for the Administration of State Revenues (**Division of Revenue**), a net reduction of $9.5 million (25.4 percent) from FY 2004. This decrease primarily reflects the elimination of FY 2004 supplemental appropriations totaling $8.25 million for various collection agency services. In addition, the division anticipates savings of $1.2 million from its "forms reduction initiative" which will lower "E-file" thresholds for employer and wage reports from 50 employees to 5 employees, require EFT submission of all unemployment and temporary disability contributions, and impose mandatory "E-file" and "E-pay" for certain categories of individual taxpayers.

- As in past years, broad language is included in the FY 2004 Budget Recommendation to permit the appropriation of additional resources for both the Division of Taxation and the Division of Revenue without further legislative action.

GENERAL GOVERNMENT SERVICES

- The Governor's Budget recommends continuation funding of ($468,000) for administration of the **Garden State Preservation Trust.** Established pursuant to P.L.1999, c.152, the GSPT is the entity responsible for overseeing the State's progress towards achieving the goal of preserving open space and farmland and for providing funding for this purpose to the Office of Green Acres within the DEP, the State Agriculture Development Committee in (but not of) the Department of Agriculture, and the New Jersey Historic Trust in the Department of State. As in the current year, an additional $98 million is appropriated for open space preservation in the Interdepartmental Accounts (budget page D-449).

- The Governor's Budget recommends an "off-budget" appropriation of $7.182 million for outstanding requirements related to the Office of Information Technology (OIT) Availability and Recovery Site, or OARS project, a component of the Governor's security preparedness program which will establish a disaster recovery capability for all of OIT's processing services, data functions and telecommunications, including the Emergency (9-1-1) system.

OFFICE OF ADMINISTRATIVE LAW

- The Governor's budget recommends continuation funding of $8.5 million for the Adjudication of Administrative Appeals program (**Office of Administrative Law**). Of that amount, $5.3 million is appropriated from the General Fund and $3.2 million is appropriated "off-budget" from Other funds, primarily from judicial hearing receipts. The

Key Points (Cont'd)

OAL is charged with the development and administration of a fair, comprehensive and uniform system of administrative practice and procedures in the Executive Branch of State government.

STATE SUBSIDIES AND FINANCIAL AID: GRANTS-IN-AID

- The Governor's FY 2005 budget recommends $865.3 million in Grants-In-Aid from the Property Tax Relief Fund for Direct Tax Relief and Homestead Rebate programs. This amount is the same as the FY 2004 adjusted appropriation. Details of these programs follow.

- The Governor's budget recommends $517.7 million, unchanged from the adjusted appropriation in FY 2004, for payments to senior, disabled and low income homeowners and tenants under the **Homestead Property Tax Rebate Program** (P.L.1990, c.61). According to the Executive's "Budget in Brief", in FY 2005 this program will provide an estimated 1.6 million rebate checks to eligible homeowners and tenants with taxable incomes not exceeding $100,000. Under proposed budget language, the maximum rebate amount for senior/disabled recipients will continue to be "capped" at the 2002 tax year level of $775 instead of increasing to $810 as would otherwise occur under statutory provisions providing adjustments for inflation.

- The FY 2005 budget recommends funding of $48 million from the Property Tax Relief Fund for the **Senior and Disabled Citizens' Property Tax Freeze** program under P.L.1997, c.348, which reimburses certain low income senior and disabled residents for increases in property taxes paid on their homes. This recommended funding level is increased from the FY 2004 adjusted appropriation by $25 million, or 108.7 percent.

- According to the Executive's "Budget in Brief", about 130,000 residents may receive "Freeze" reimbursements in FY 2005, an increase of approximately 50,000 over the level of participation in FY 2004. Some small portion of this increase in the beneficiary population is attributable to a 1.4 percent increase in the income ceiling on eligibility. Much of the increase, however, is among taxpayers who met the statutory qualifications for Freeze program payments last year, but were excluded from benefits under the program by language in the FY 2004 Appropriations Act closing the program to new participants. Under proposed budget language, eligibility for the Senior and Disabled Citizens' Property Tax Freeze program is opened again to most qualified taxpayers. The proposed language, however, excludes the amount of any tax year 2003 increase in a qualified participant's property tax from reimbursement under the program; absent this language, tax increases for that year would be reimbursable to these taxpayers.

- The Governor's FY 2005 Budget recommends $299.6 million for the **New Jersey School Assessment Valuation Exemption Relief (NJ SAVER)** program, a decrease of $25 million (7.7 percent) below the FY 2004 adjusted appropriation of $324.6 million. NJ SAVER provides 1.1 million homeowners with direct relief equal to a portion of the school taxes paid on the assessed value of eligible primary residences. The budget proposal retains from FY 2004 two language provisions that would reduce NJ SAVER payments below the amounts payable under the terms of the statute authorizing the program. First, eligibility for the payments would be restricted to individuals and couples with annual incomes not exceeding $200,000. Second, payments under the program would be made at less than one-half of the full amount payable under the authorizing act.

Key Points (Cont'd)

STATE SUBSIDIES AND FINANCIAL AID: STATE AID

- The Governor's Budget recommends a total of $234.6 million in State Aid, of which $98.3 million is appropriated from the General Fund and $136.3 million is appropriated from the Property Tax Relief Fund. The total FY 2005 State Aid figure for Treasury represents an 8.3 percent increase from the FY 2004 adjusted appropriation. Details of these programs follow.

- Funding for the **County Boards of Taxation** in FY 2005 is recommended at $1.5 million, unchanged from the FY 2004 level. Counties are reimbursed by the State for costs associated with county tax board members, the number of which is established for each county based on its population as determined by the federal decennial census.

- The Governor's FY 2005 Budget recommends $57.3 million in General Fund State Aid for **Solid Waste Management - County Environmental Investment Debt Service**, a decrease of $2.8 million (4.7 percent) from the FY 2004 adjusted appropriation for this purpose. This aid assists the counties in meeting debt service requirements for solid waste treatment investments (primarily stranded costs associated with incinerator construction).

- The Governor's FY 2005 Budget recommends a total of $23 million in State Aid payments from the Property Tax Relief Fund to reimburse municipalities for senior and disabled citizens' property tax exemptions. This amount is $3 million (11.5 percent) less than the FY 2004 adjusted appropriation for these reimbursement payments.

- The Governor's Budget recommends $86 million in State Aid payments from the Property Tax Relief Fund to reimburse municipalities for **veterans' property tax exemptions**. This amount represents an increase of $3 million (3.6 percent) over the FY 2004 adjusted appropriation.

- The FY 2005 Budget recommends an appropriation of $7.0 million in General Fund State Aid for the **State Contribution to the Consolidated Police and Firemen's Pension Fund** (CPFPF); this constitutes an increase of $5.0 million (250 percent) from the adjusted appropriation for FY 2004. Even though it has no active members, the CPFPF is funded on a reserve basis. The appropriation will meet the State's obligation for its portion of a deficiency that has arisen in the funding of the system's accrued liability. The deficiency is attributable primarily to the failure of fund assets to achieve a return at the assumed rate; a small portion of the deficiency is attributable to a benefit enhancement for retirees payable under P.L.2001, c.4.

- The Governor's Budget recommends $7.9 million from the Property Tax Relief Fund for **Debt Service on Pension Obligation Bonds** issued to finance the unfunded accrued liability of the State administered retirement systems. This represents a decrease of $.3 million (3.7 percent) from the FY 2004 adjusted appropriation for this purpose.

- The Governor's Budget recommends $19.4 million from the Property Tax Relief Fund for **Police and Firemen's Retirement System (PFRS) - Post-Retirement Medical**, a $1.7 million (9.6 percent) increase over the FY 2004 adjusted appropriation. This appropriation reflects the provisions of P.L.1997, c.330, which authorize State-paid post-retirement medical benefits for certain PFRS retirees.

- The FY 2005 Budget recommends an appropriation of $16.9 million for the PFRS to cover

Key Points (Cont'd)

the State's liability for funding the increase in local employers' costs resulting from (i) the transfer of certain public safety employees from the Public Employees' Retirement System to PFRS under P.L.1993, c.247, and (ii) the enhancement of the benefit to widows of PFRS retirees under P.L.1991, c.511. As of this writing, the actuarially prescribed amount of this obligation in FY 2005 has not been made available, but the Office of the State Treasurer has stated that the recommended appropriation represents funding of the obligation at between 20 percent and 40 percent of the prescribed amount.

- The Governor's Budget includes a recommended appropriation of $8.9 million for the Police and Firemen's Retirement System (PFRS) to meet the State's obligation for support of the local cost of benefits provided to plan members under P.L.1979, c.109 (increasing the PFRS "special" retirement benefit); this amount represents an increase of $3.3 million (57.7 percent) above the FY 2004 adjusted appropriation. As with the State contribution covering local PFRS employers' costs under chapters 247 and 511, this appropriation represents funding of the obligation at some level between 20 percent and 40 percent of the full, actuarially prescribed amount.

- The Governor's Budget recommends a FY 2005 "off-budget" distribution under P.L.1997, c.167 from the **Energy Tax Receipts Property Tax Relief Fund** ("ETR Fund") to municipalities in the amount of $787.7 million. The 1997 act replaced the previous method of taxing public utilities and created a new distribution of funds to municipalities that is no longer tied to actual utility property or other tax collections. Under the 1997 law, the level of energy tax replacement aid was set at $755 million for FY 2002 and each subsequent fiscal year. Under a 1999 amendment, the amount of replacement aid was to be indexed for increases in local government costs beginning in FY 2003. The FY 2003 Appropriations Act held funding at the FY 2002 level; the FY 2004 Appropriations Act provided for an increase, to adjust for inflation over FY 2003, of roughly 1 percent. The proposed $25 million in additional municipal aid from the ETR Fund represents an increase of 3.3 percent from FY 2004.

MANAGEMENT AND ADMINISTRATION

- The Governor recommends $10.5 million for the **Treasurer's Office** for FY 2005 which reflects a $200,000 decrease (1.8 percent) in general operating expenses from the current adjusted appropriation.

PROTECTION OF CITIZENS' RIGHTS

- The Governor's Budget recommends effectively flat funding of $80.0 million for the **Office of the Public Defender** (OPD). The OPD provides trial and appellate legal services to: criminal defendants; juveniles charged with delinquency offenses; individuals making application to the Intensive Supervision Program of the Administrative Office of the Courts; individuals involuntarily committed to mental hospitals; abused and neglected children; and civilly committed sexual offenders.

- Proposed language contained within the budget of the Division of Youth and Family Services in the Department of Human Services would provide the OPD and the Department of Law and Public Safety with up to $15.8 million in additional funding for their roles in

Key Points (Cont'd)

implementing the Child Welfare Reform plan. This funding will add additional Law Guardians and support staff which will reduce attorney caseloads and court backlogs with respect to both child abuse and neglect proceedings.

- The Governor's Budget recommends a Grants-in-Aid appropriation of $14.0 million for Legal Services of New Jersey, a $2.0 million (16.7 percent) increase from the current level. This funding will partially offset an anticipated $4.4 million decrease in revenues available for the Legal Services program during calendar year 2004 from Interest on Lawyers' Trust Accounts, or IOLTA funds. Legal Services, a private, not-for-profit agency that provides legal assistance and representation to low-income individuals in civil matters is primarily supported by State and IOLTA funds, with additional support coming from the federal government and either county or private sources.

DEBT SERVICE

- The Governor's Budget for the department includes $381.3 million for Debt Service on general obligation bonds. This represents an increase of $6.8 million (1.8 percent) from the FY 2004 adjusted appropriation for debt service under the department

REVOLVING AND OTHER FUNDS

- The Budget Recommendation includes the following appropriations from other revolving funds in the Department of the Treasury: $98.2 million to support the data processing centers of the Office of Information Technology (OIT); $55.9 million for the Distribution Center; $17.4 million for the State Central Motor Pool; $6.7 million for the Division of Property Management and Construction; $2.3 million for the Print Shop; $1.6 million for the Capitol Post Office; and $1.3 million for the Office of Public Communication. These intra-governmental operations are provided on a "fee for service" basis, the receipts of which are utilized for the continuing operation of the respective service.

- All of the recommended revolving fund appropriations are unchanged from FY 2004 with two relatively minor exceptions: the State Distribution Center is reduced by $459,000 (less than one percent) due to savings from an initiative which will enable agencies to purchase directly from office supply vendors rather than utilizing a warehouse and distribution system and the Central Motor Pool will save $200,000 (1 percent) from closing a heavy truck repair facility.

PERSONNEL

- The position data displayed in the Governor's Budget indicate that the FY 2005 budget would fund a total of 6,714 positions, an increase of 366 positions (5.8 percent) from the current total of 6,348 filled positions. Most of this increase (245 positions) is reflected in the Citizens Rights (Public Defender) program class.

Analysis of the Higher Educational Services portion of the Department of the Treasury budget (pages D-396 to D-399) is contained in a separate booklet: "Higher Educational Services."

Analysis of the New Jersey Commerce and Economic Growth Commission, the Economic Planning and Development Statewide program, and the New Jersey Commission on Science and

Key Points (Cont'd)

Technology portions of the Department of the Treasury budget (pages D-400 to D-406) are contained in a separate booklet: "New Jersey Commerce and Economic Growth Commission and Related Economic Development Programs."

Background Paper:

Program Description and Overview (cont'd)

The Department of the Treasury is the central management agency of State government. The department is the third largest department in terms of resources, surpassed only by the Departments of Human Services and Education. It has major responsibilities in guiding the direction of State operations through its planning, management and budget components; in securing the State's financial interests through the collection of taxes and other revenues and the investment of State assets; and in the distribution of significant amounts of State aid to individuals universities, and local governments.

In addition to the above responsibilities, certain regulatory, legal, economic development and business reporting functions fall within the Department of the Treasury organization.

The core programs in the Department of the Treasury are as follows:

- Treasurer's Office
- Office of Management and Budget
- Office of Public Finance
- Division of Pensions and Benefits
- Division of Taxation
- Division of Revenue
- Division of Investments
- Division of State Lottery
- Division of Contract Compliance and Equal Employment Opportunity in Public Contracting
- Division of Purchasing and Inventory Management
- Division of Property Management and Construction

A number of agencies are allocated "in but not of" the Department of the Treasury. Each of the eleven programs listed below is organizationally within the department but autonomous in its operation. The New Jersey Commerce and Economic Growth Commission, the New Jersey Commission on Science and Technology, and the New Jersey Economic Development Authority are discussed in a separate OLS analysis, as are higher education grants administered through the Department of the Treasury. Allocated "in but not of" the Department of the Treasury are the following:

- Garden State Preservation Trust
- Casino Control Commission
- Board of Public Utilities
- Ratepayer Advocate
- Office of Administrative Law
- Office of the Public Defender
- Office of Legal Services
- Office of Information Technology (OIT)
- New Jersey Commerce and Economic Growth Commission
- New Jersey Commission on Science and Technology
- New Jersey Economic Development Authority

The Governor's FY 2005 budget reflects the Executive Branch reorganization which occurred in FY 1999. The Department of Commerce and Economic Development was dissolved in September 1998 and the New Jersey Commerce and Economic Growth Commission was established; the Division of Commercial Recording and certain functions within the Bureau of Wage Reporting were integrated into the Division of Revenue's operations; and certain legal services

Program Description and Overview (cont'd)

programs, including the Office of Administrative Law, the Public Defender and the Office of State Legal Services were transferred "in but not of" the Department of the Treasury from the Department of State and the Department of Community Affairs respectively.

Core Programs

The following describes the units within the department in terms of their duties and responsibilities and provides an overview of the resources available to each unit.

The **Treasurer's Office** provides fiscal, personnel, and other services related to the overall management of the department. The Treasurer's Office develops and exercises general policy and administrative control over operations and often has been the locus of projects and programs of special interest to the Governor. Over the years such projects and programs have included the Camden aquarium and the New Jersey Performing Arts Center (NJPAC).

The Treasurer's Office has responsibility for public finance activities associated with debt issuance and management through the **Office of Public Finance**. In addition, the Treasurer's Office has responsibility for the Federal Liaison Office, which represents the Governor and assists State agencies in negotiations with federal agencies to maximize the State's share of federal grant monies and entitlements, and the **Division of Contract Compliance and Equal Employment Opportunity in Public Contracts** (formerly called the Public Contracts Affirmative Action Office), which is responsible for ensuring that any firm contracting with a public agency in the State provides equal opportunity in employment.

For FY 2005, the Governor has proposed essentially a continuation level of funding for all components of the department's Management and Administration functions. The Budget Recommendation provides $10.5 million for the **Treasurer's Office**, a $200,000 decrease (1.8 percent) in general operating expenses from the FY 2004 adjusted appropriation. State funding for the Division of Contract Compliance is flat at $1.6 million for FY 2005, although this amount is supplemented with fee revenues appropriated through budget language. Similarly, the Office of Public Finance is largely supported by "off budget" appropriations of revenue from service fees charged to State agencies, fees realized through the cost of bond issuance and from investment earnings.

The **Office of Management and Budget** (OMB) plans, prepares and administers the State budget. It manages and monitors the day-to-day operation of the State's financial systems, including the publication of the State's annual financial statements and processing payments to vendors. It provides planning, review and oversight for federal policies which relate to State interests and for capital construction projects. In addition, it provides organizational, technical and productivity analyses and evaluates all requests for data processing and telecommunications services and equipment in State government in conjunction with the Office of Information Technology (OIT).

The Governor's FY 2005 Budget recommends $19.5 million for the Office of Management and Budget (OMB), a $101,000 decrease from the current adjusted appropriation. The proposed reduction is attributable to improvements in the position review process which will allow current position control staff to be redeployed. As in prior years, a special purpose appropriation of $1.1 million, plus language providing supplemental budget authority, is provided for Independent Audits. The Governor's Budget indicates that 193 OMB positions are funded in FY 2005, an increase of 10 positions.

The **General Government Services** (GSS) helps State agencies meet their needs by

Program Description and Overview (cont'd)

purchasing and maintaining assets and by providing products, services and facilities. GSS includes the Purchasing and Inventory Management program and the Property Management and Construction - Property Management Services program as well as other programs which manage real estate, Statewide purchasing, rental properties, insurance, employee housing, the State Post Office, and State vehicles.

Many of GSS's programs operate as revolving funds, which receive all or most of their revenue from direct charges to user agencies. For many other GSS programs, language in the appropriations act often permits these programs to draw on resources from either revolving funds or special revenue resources. In some, but not all cases, the amount of non-General Fund resources available to a program is capped at a certain level.

The Governor's Budget recommends a Direct State Services appropriation for GSS (which for this purpose includes appropriations for all GSS programs except the Garden State Preservation Trust and the Division of Pensions and Benefits) of $23.6 million in FY 2005, a net reduction of $5.0 million (17 percent) from the FY 2004 adjusted appropriation of $28.6 million. This decrease is attributable to a $5.3 million reduction in the line of credit available through the Fleet Renewal Management program in the Division of Purchasing and Inventory Management. This program, which has received appropriations totaling almost $50 million since FY1999, represented a major initiative to replace a high percentage of the State's aging vehicle fleet. Since the program was undertaken, the average age of the State's fleet has been reduced from approximately eight years to roughly two to three years. Offsetting this line of credit reduction are net changes of about $550,000 related to the division's procurement reform processes.

The **Division of Pensions and Benefits** manages State and public employee benefit programs, including the State Health Benefits Program and seven public retirement systems for State and local employees in New Jersey.

The entire budget of the Division of Pensions and Benefits is charged back to the various pension funds and employee benefit programs. In FY 2005, the division's budget is a relatively flat $31.6 million with relatively minor savings anticipated from mandating EFT benefits payments to all new retires. This amount will support 357 positions, 7 more positions than the FY 2004 level.

Since FY 1995, the division's budget has been augmented by additional funds appropriated pursuant to budget language. Such language is continued in the Governor's FY 2005 Budget. In addition, in FY2000 the division began studying and implementing a significant project to "re-engineer" the State's pension and health benefits computer system, which was also funded off-budget through language. This initiative, which calls for a complete replacement of all Pension and Benefits application software was previously projected to cost approximately $51.4 million over five years, subject to the reimbursement of the General Fund by the pension system.

The Governor's Budget recommends continuation funding of $468,000 for administration of the **Garden State Preservation Trust** (GSPT). Established pursuant to P.L.1999, c.152, the GSPT is the entity responsible for overseeing the State's progress towards achieving the goal of preserving open space and farmland and for providing funding for this purpose to the Office of Green Acres within the DEP, the State Agriculture Development Committee in (but not of) the Department of Agriculture, and the New Jersey Historic Trust in the Department of State. As in the current year, an additional $98 million is appropriated for open space preservation in the Interdepartmental Accounts (budget page D-449). These funds are available for acquisition and preservation projects through the GSPT.

Program Description and Overview (cont'd)

The Division of Taxation (Taxation Services and Administration) administers the tax laws of the State, performs office and field audits of tax returns and taxpaying entities, prepares tax refunds, investigates tax matters having civil or criminal potential, determines certain state aid distributions and provides other tax-related services.

The amount recommended in FY 2005 is $88.2 million, $3.7 million (4 percent) less than the FY 2004 adjusted appropriation. This net decrease reflects the elimination of $4.8 million in supplemental funding for debt collection services contracts, plus savings of $825,000 from a "forms reduction initiative" available because of the increase in alternative (electronic) tax filings. These reductions are partially offset by recommended increases for the division attributable to the hiring of additional tax auditors ($554,000) and the inclusion of a special purpose appropriation($1.175 million) for the Property Assessment Management System (PAMS) to revise the division's program for aggregating and analyzing local real property data that the State, county tax boards and municipal assessors use to generate tax lists, assessments, and various reports. The recommended budget is expected to fund 1,489 positions, an increase of 111 positions over the current year.

In FY 1992, the Division of Taxation was given broad authority through language in the appropriations act to offset administrative costs against revenue collections. The FY 2005 budget includes a number of such language provisions. These provisions permit the division, with the approval of the Director of the Division of Budget and Accounting (OMB), to do the following: to use receipts from the sale of confiscated equipment, materials and supplies under the "Cigarette Tax Act"; to appropriate such sums as are necessary for the administration of the homestead property tax reimbursement established pursuant to P.L. 1997, c.348; to appropriate receipts from the Solid Waste Services Tax Fund; to appropriate funds to offset administrative costs of the New Jersey Urban Enterprise Zone Act and the Tourism Improvement and Development District Act; to appropriate revenues from escheated property; to appropriate additional sums for the costs associated with enhanced compliance programs; and to appropriate the unexpended balances in the Revenue Management account. In recent budgets, this authority has provided the Division of Taxation with resources beyond those available through a direct appropriation.

Since the late 1980's with the first Tax Amnesty program, the Division has focused more resources on programs to improve compliance among New Jersey taxpayers. Section 34 of P.L. 1991, c.185 created the Interagency Cost Recovery Task Force, otherwise known as the Cheater Beater program. Language provided broad authority to the Division of Taxation in the Department of the Treasury, the Division of Law in the Department of Law and Public Safety and "...any other unit of State government to fund the costs of auditors, attorneys, and other staff and other costs..." from "...delinquent tax judgments, delinquent student loans, administrative fines and penalties, unclaimed property, escheats, overpayments of state entitlements and any other debts owing to the State or its agencies."

Although the Cheater Beater program is no longer a separate program, the Division has continued many of its audit and compliance initiatives. Since FY 1992 the number of auditors has grown from 256 to 436 in FY 2004. During the same period, the number of collectors has grown from 167 to 290. The Division estimates that it will maintain effectively the same number of positions for both functions in FY 2005. In addition, the Division has continued to utilize the services of a private contractor to collect back taxes due to the State.

The 2002 Tax Amnesty program, established pursuant to P.L. 2002, c.6, was one of a number of initiatives intended to help close a severe State budget shortfall. The most recent program provided for a 60-day period of amnesty to end no later than June 10, 2002, for the payment of any outstanding State tax liabilities arising from tax filings due on and after January 1,

Program Description and Overview (cont'd)

1996 and prior to January 1, 2002. According to the Division of Taxation, the program resulted in the collection of an estimated $276 million in back taxes.

The Governor's Budget also appropriates a flat $6.2 million in "off budget" revenues for the Unclaimed Property (Escheats) program in the Division of Taxation. This program attempts to locate owners of unclaimed property, such as bank accounts, wage checks, certificates of deposit, bonds and stocks. When no individual claims the property or no individual is legally qualified to inherit the property, the property reverts to the State. The escheats program was expanded in FY 2003 pursuant to P.L.2002, c.35 (C.46:30B-7.2 et. seq). which clarified and broadened the categories of property which may escheat to the State and reduced the time required for unclaimed property to escheat to the State. Language in the budget permits the administration of this program to be paid out of the revenues derived from escheated property.

The Division of Revenue was created pursuant to Executive Reorganization Plan 97-001 to provide one central location for revenue management and collections. In FY 1999, certain wage reporting functions from the Division of Wage and Reporting (Reorganization Plan 003-1998) and various business reporting procedures administered by the Office of Commercial Recording (Reorganization Plan 004-1998) were consolidated into the Division of Revenue. Included in this initial transfer were revenue management responsibilities for the following programs: Unemployment Insurance Tax, State Disability Benefits Tax, the Second Injury Fund, Temporary Disability Insurance Assessments, CAARS (Catastrophic Illness in Children, Worker and Community Right to Know, Pollution Prevention Control) Assessments, Health Care Subsidy and Workforce Development Partnership. These functions include responsibilities for revenue management such as receiving reports, billings and correspondence; remittance processing; data entry; imaging; and providing services to the public and legal communities, including filing and processing information.

For FY 2005, the Governor has recommended an appropriation of $27.8 million for the division, a net reduction of $9.5 million (25.4 percent) from FY2004. This decrease primarily reflects the elimination of FY 2004 supplemental appropriations totaling $8.25 million for various collection agency services. In addition, the division anticipates savings of $1.2 million from its "forms reduction initiative" which will lower "E-file" thresholds for employer and wage reports from 50 employees to 5 employees and require EFT submission of all unemployment and temporary disability contributions, and impose mandatory "E-file" and "E-pay" for certain categories of individual taxpayers. As in prior years, the budget includes recommended language which would permit the appropriation of additional funds as needed in FY 2005. The recommended budget is expected to fund 483 positions, an increase of 17 positions from the current year.

The Division of Investments (Management of State Investments) currently manages an investment portfolio of approximately $76 billion in State funds (including the various State pension funds, the State Disability Benefits Fund, the General Investment Fund, and the State of New Jersey Cash Management Fund), controls the principal proceeds and interest receipts, and provides investment services to other State agencies, public authorities and local governments. It publishes detailed monthly reports of operations and presents an annual report to the Governor and Legislature.

Following a two year decline, from June 2000 to June 2002, in the value of the assets of the State's pension funds, the Governor initiated a review of the State's investment strategy and portfolio management operations. During the Fall of 2002, the Governor appointed a non-partisan committee, whose membership includes two former governors of the State, to assess the status of the State's investment portfolio and provide recommendations for changes to the State's investment management strategy. In addition, the department hired a consultant, Independent Fiduciary

Program Description and Overview (cont'd)

Services (IFS), to assess the performance of the State's funds. In September 2003, IFS delivered its final report in which it offered some 79 recommendations designed to enhance the operations and performance of the division, the most controversial of which proposed the hiring of external money managers to make nontraditional investment decisions. (For more information on this topic, please turn to the background paper, "Pension Fund System Performance Issues," beginning on page 53 of this report.)

For FY 2005, the Governor has recommended a continuation appropriation of $6.6 million in Direct State Services appropriations for the Division of Investments. The division's budget is expected to support 68 positions in FY 2005 which is increased by 5 positions from the current year. The administrative costs of this program are charged back to the investment portfolio. Language permitting the appropriation of additional resources in FY 2005 for expenses from the investment earnings of the various pension and health benefits funds administered by the Division is also recommended for continuation.

The **Division of the State Lottery** sponsors lottery games, raising State revenue through the sale of lottery tickets. By law, a minimum of 30 percent of gross lottery revenues is dedicated to State Aid for education and institutions. In FY 2005, the State Lottery is expected to transfer $795 million to the General Fund for these purposes, a slight increase over the $783 million anticipated in the current budget. The State Lottery Fund Schedule on page H-60 of the Governor's FY 2005 budget shows the programs which are in part supported by these funds. Included are institutions and programs in the Departments of Agriculture, Education, Human Services, Military and Veterans' Affairs, and Higher Educational Services.

The Division's operations first came on budget in FY 1987. Since that time, the Division has been given broad authority to augment its appropriations through language. The FY 2005 budget continues four such language provisions. These provisions permit the Division to do the following: to use whatever sums are necessary in order to pay commissions, prizes, and expenses for developing games; to use State Lottery Fund receipts in excess of anticipated contributions to education and state institutions for administrative costs (this language would permit the Division to use amounts in excess of the $795 million anticipated as budgeted revenues in FY 2005); to appropriate out of receipts from communications fees any sums necessary for communications costs; and to earn and use revenues from the sale of advertising.

The Governor's FY 2005 budget projects net sales of $2.2 billion to be generated by 6,000 agents and 2,028 drawings. (This compares to net lottery net sales a decade ago of $1.4 billion generated by 5,150 agents and 885 drawings.) The steady growth in Lottery revenues available for General Fund purposes is partly attributable to the State's participation, since May 1999, in the "Big Game," the popular, multi-state, mega-jackpot game, which, in the most recently audited year, FY2003, contributed almost $300 million in lottery revenue. On May 15, 2002, New Jersey joined eight other states in launching the first drawing of "Mega Millions," an enhanced version of the Big Game. In addition, New Jersey recently became the first State to introduce an online lottery game, "CyberSlingo."

"In But Not Of" Programs

The **Casino Control Commission** is funded from receipts of the Casino Control Fund, which receives fees primarily from the issuance and renewal of casino licenses and work permits in Atlantic City. The Commission is responsible for the regulation of legalized casino gaming in New Jersey and for the collection of all license fees and taxes imposed by the New Jersey Casino Control Act. The Commission regulates the operation of 12 casino hotel complexes (although a 13th casino,

Program Description and Overview (cont'd)

The Borgata, opened in Summer 2003, a merger of the Claridge casino with Bally's Park Place in FY 2003 eliminated one casino license) and licenses all employees and ancillary companies conducting business with the casino industry.

The Governor's budget recommends continuation funding of $27.9 million in FY 2005 for the Commission. Position data in the FY 2005 budget indicate that the recommended budget will support 364 positions, an increase of 14 over the current year.

In FY 1999, the **Office of Administrative Law (OAL)** was transferred from the Department of State to the Department of the Treasury pursuant to Reorganization Plan 004-1998. The Office of Administrative Law is charged with the development and administration of a fair, comprehensive and uniform system of administrative practice and procedures in the Executive Branch of State government. It is intended to be a facilitator between the public and State agencies in the development and implementation of and accessibility to the regulatory process which includes the impartial and expeditious resolution of disputes and the public's guarantee to notice and opportunity to comment on agency rulemaking.

The OAL conducts hearings for most State agencies and supervises rulemaking activities for all State agencies. The OAL staff reviews agency rulemaking to determine compliance with the Administrative Procedure Act and the OAL procedures manual. The OAL oversees the publication of the New Jersey Administrative Code and the New Jersey Register.

The Governor's FY 2005 Budget recommends flat funding of $8.5 million in State and other funds for OAL which will support 118 positions, an increase of 5 positions over the current year. Funding for the OAL includes a direct State appropriation of $5.3 million and $3.2 million in other funds, primarily from judicial hearing receipts.

The **Office of Information Technology (OIT)** was established in but not of the Department of the Treasury pursuant to Executive Order No. 87, dated September 4, 1998. Under the direction of the Chief Information Officer and with oversight by a public/private board of directors, OIT assumed all of the responsibilities of the former Office of Telecommunications and Information Systems which, since October 1984, had been responsible for consolidating and coordinating information processing activities of the Executive Branch.

OIT has operational responsibility for the State data centers and the Garden State Network, a Statewide integrated communications network capable of carrying data and voice transmissions. It is also responsible for evaluating all requests for data processing and telecommunications services and equipment in State government. This evaluation process includes system analysis and design activities, consulting services and general management and planning for data processing and telecommunications systems, including the Emergency 9-1-1 system, in the State.

OIT operates as a revolving fund, supported by charges against user agencies. Its recommended authorized spending level in FY 2005 is $98.1 million, unchanged from the current year. This appropriation is expected to support 966 positions next year.

In addition to the revolving funds available to OIT in FY 2005, the Governor's Budget includes proposed language which would dedicate up to $7.2 million in car rental surcharge receipts to the Office of Information Technology (OIT) Availability and Recovery Site, or OARS project, a component of the Governor's security preparedness program, which is intended to establish a disaster recovery capability for all of OIT's processing services and data functions. Funding for OARS, which is a multi-year project estimated to cost about $13.3 million, had been

Program Description and Overview (cont'd)

requested (and previously funded) through the department's Capital Construction budget. The FY 2003 budget provided an initial capital appropriation of $5.5 million for OARS, of which approximately half was unexpended and carried forward into the current budget year. The $7.2 million which would be provided off-budget through the recommended language had been included in the department's FY 2005 Capital Budget request, but was not included in the Capital Recommendation. According to the request, "FY 2005 capital funding is urgently needed for final construction and purchase of remaining hardware/software necessary to create the infrastructure for the Garden State Network and the backup and recovery of servers and the mainframe data."

The **Board of Public Utilities** is currently organized "in but not of" the Department of the Treasury, where it has resided since 1994. The Reorganization Plan (No. 001-94) redesignated the Board of Regulatory Commissioners (BRC) as the Board of Public Utilities (BPU) and reconstituted the BPU in the Department of the Treasury. In addition, that reorganization eliminated the Department of the Public Advocate and transferred a residual Division of Ratepayer Advocate to the oversight of the BPU.

The BPU is a cabinet level regulatory authority with a statutory mandate (R.S.48:2-1 et. seq.) to ensure safe, adequate, and proper public utility services at reasonable rates for customers in New Jersey. Accordingly, the BPU regulates critical services such as natural gas, electricity, water, sewer, and telecommunications including cable television. The Board addresses issues of consumer protection, energy tax reform, deregulation of energy and telecommunications services, and the restructuring of utility rates to encourage energy conservation and competitive pricing in the industry. To accomplish its mandate, the Board regulates rates for such utilities by conducting comprehensive reviews to determine the fairness and reasonableness of rates. The Board also has general supervisory responsibility for monitoring utility service, responding to utility consumer complaints, and investigating utility accidents. In 1999, legislation establishing the framework and the necessary time schedules for the deregulation and restructuring of the electric and natural gas utilities in this State was enacted. The Electric Discount and Energy Competition Act ("EDECA," P.L. 1999, c.23) is responsible for significantly increasing the responsibilities assigned to the BPU.

The Governor's Budget recommends a Direct State Services appropriation of $28.8 million for the Economic Regulation Program, a reduction of $215,000 (or less than one percent) from the current year. This program class includes BPU, budgeted at $22.9 million, and the Ratepayer Advocacy Program, budgeted at $5.9 million; both are funded by assessments levied on various utilities conducting business within the State. Proposed language would permit the BPU to supplement its $22.9 million recommended appropriation by up to $3 million from revenues derived from fines, penalties and settlements imposed upon utilities for various violations, which if approved, would allow the BPU to operate without increasing its industry assessment.

Grants-in-Aid funding for "Lifeline Credit Program," established pursuant to P.L.1979, c.197 (C.48:2-29.15 et seq.) and the Tenants' Lifeline Assistance Program, established pursuant to P.L. 1981, c.210 (C.48:2-29.31 et seq.) is recommended to remain unchanged at $70.8 million for FY 2005. These two statutorily established programs, which were budgetarily reallocated to the BPU from the Department of Health and Senior Services by the FY 2004 appropriations act, provide energy assistance grants to senior citizens and the disabled and are funded through an assessment on energy bills. (Broad authority for the BPU to establish and administer such an assessment was previously established pursuant to the energy deregulation law, "EDECA.") Although the BPU administers funding of these programs through the Universal Service Fund (into which assessment revenues are deposited), the Department of Health and Senior Services, under a Memorandum of Understanding agreement with the BPU, remains responsible for administration of the grants.

Program Description and Overview (cont'd)

In FY 2005, the BPU will regulate 5 investor owned electric utilities, 4 gas companies, 140 telephone and telegraph companies, 67 water and sewer companies, 10 municipal water companies, and 36 cable services.

The **Office of the Public Defender** (OPD) was created pursuant to P.L. 1967, c.43 "in but not of" the Department of Institutions and Agencies to provide representation for indigent defendants in criminal cases. (Prior to 1967, legal representation for indigent defendants, as guaranteed by the U.S. Constitution, was handled in New Jersey on a case-by-case basis.) In 1974, when the Department of the Public Advocate was created (P.L. 1974, c.27), the Office of the Public Defender became part of that department. Pursuant to the Public Advocate Restructuring Act (P.L. 1994, c.58), the Department of the Public Advocate was abolished and the Office of the Public Defender was placed in but not of the Department of the State. Subsequently, in 1998, under Reorganization Plan No. 004-1998, the Office of the Public Defender was transferred from the Department of State to the Department of the Treasury.

Funding for the Protection of Citizens Rights program includes both the Office of the Public Defender and the **Legal Services program**, both of which provide legal services to indigent clients. The OPD assists low income residents in criminal matters; the Office of Legal Services assists them in civil matters. The OPD is a State office staffed by State employees. Its primary source of funds is the State General Fund. Legal Services of New Jersey is a private non-profit corporation staffed by private attorneys. Its funding is primarily from three sources: a State grant, Interest On Lawyers Trust Account (IOLTA) fees, and to a lesser extent, federal funding.

Approximately 83 percent of the OPD's funding, or $66.4 million, is appropriated to the 22 regional offices and programs of the Trial Services to Indigents and Special Programs budgetary unit. Through this program, the Public Defender represents indigent criminal defendants; indigent defendants in Megan's Law notification hearings; and individuals who are either applying to the Intensive Supervision program or who are in the program and have violated probation. Through its Law Guardian program, the Public Defender also represents abused and neglected children in Family Court proceedings. The driving factor for expenditures within the Law Guardian unit is the number of clients assigned to it by the courts.

In September 1998, the Law Guardian (Child Abuse or "Title 9") program was expanded to respond to the increased caseload associated with the implementation of the federal "Adoption and Safe Families Act of 1997," Pub.L.105-89, the purpose of which was to speed-up the adoption of children placed in foster care. As a result of the act, the Office began representing both children and indigent parents in so-called "Title 30" cases in which the parental rights of biological parents are sought to be terminated in certain cases. In mid-1999, pursuant to P.L. 1999, c.53 (N.J.S.A.9:3-45.7 et seq.), the Office created the Parental Representation Unit (PRU) within the Law Guardian program to provide attorneys for indigent parents in some 1,200 termination of parental rights proceedings annually.

The Governor's FY 2005 Budget recommends a further expansion of the OPD's Law Guardian unit in association with implementation of the State's Child Welfare Reform plan. In accordance with the plan's goal to reduce caseloads within the Division of Youth and Family Services, the Governor's Budget includes language permitting the transfer of up to $15.8 million to the OPD and the Department of Law and Public Safety for the addition of some 220 positions to "speed children's cases to court." According to OPD's budget request, this funding will add additional Law Guardians and support staff which will reduce attorney caseloads and court backlogs with respect to both Title 9 and Title 30 proceedings.

Program Description and Overview (cont'd)

The Legal Services Program was transferred from the Department of Community Affairs to the Department of the Treasury in FY 1999 pursuant to Reorganization Plan No. 002-1998. Legal Services programs are the primary means by which society provides free legal assistance in civil matters to people who cannot afford the cost of legal representation. Although the types of cases handled vary from county to county, Legal Services of New Jersey provides support to indigents primarily in four areas: Housing - primarily tenancy and eviction matters; Family Matters - divorce, separation, domestic violence, child support and termination of parental rights; Income Maintenance - Social Security, Work First New Jersey, Food Stamps and other such programs; and Consumer Matters - bankruptcy, collections, warranties, unfair sales practices and public utilities. To a lesser extent, other cases concern education, health, employment and juvenile matters.

Effective December 30, 2002, the Legal Service program was re-organized from a network of seventeen local offices to a network of six regional offices, which provide legal services to clients in all 21 counties, and Legal Services of New Jersey, the Statewide coordinating office in Edison. The Legal Services staff is approximately 430 Statewide, including 210 attorneys who represent, to varying degrees, some 50,000 clients annually. Each program is a not-for-profit corporation governed by a board of trustees which includes members of the local bar association as well as representatives of the eligible client population.

The Governor's FY 2005 Budget recommends a $2.0 million increase in the annual grants-in-aid appropriation to Legal Services of New Jersey. According to the Administration and the State Legal Services office, this funding will partially offset an anticipated $4.4 million decrease in revenues available for the Legal Services program during calendar year 2004 from Interest on Lawyers' Trust Accounts, or IOLTA funds. This decrease in IOLTA, largely attributable to declining bank account interest rates, represents about 12 percent of Legal Services' total current budget of approximately $38 million.

FY 2005 Budget Overview

Total resources recommended for the Department of the Treasury and its affiliated agencies and programs in FY 2005 are $3.4 billion, an increase of $16.5 million (less than one percent) over the FY 2004 adjusted appropriation. Included in this total is $2.3 billion in State budgeted appropriations (which include appropriations from the General Fund, the Property Tax Relief Fund (PTRF), and the Casino Control Fund) and $1.1 billion in Other Funds. Federal Funds constitute a minimal portion of the Department of the Treasury's resources.

The Governor has recommended level or continuation funding for many of the department's State budgeted appropriations. Some changes, however, are recommended. The most significant areas of increase are in Grants-In-Aid and State Aid paid out of General Fund resources.

- Grants-In-Aid paid out of the General Fund are recommended to increase by a net of $17 million, or 8.1 percent. This increase is primarily due to additional grant funding for Miscellaneous Higher Education ($8.9 million), the New Jersey Commerce and Economic Growth Commission ($5.5 million) and Legal Services of New Jersey ($2 million).

- Grants-In-Aid paid out of the Property Tax Relief Fund are recommended to remain the same as in FY 2004. The Governor's budget retains from that fiscal year several budget language provisions imposing limits on benefit payments and the number of eligible taxpayers under the State's Direct Tax Relief programs and Homestead Rebate program.

Program Description and Overview (Cont'd)

- State aid paid out of the Property Tax Relief fund is recommended to increase by a net $4.5 million, or 2.8 percent. Of this amount, roughly two-thirds ($3.1 million) represent increased aid to county colleges.

- The FY 2005 budget recommends $351.6 million for General Fund - Direct State Services appropriations, a decrease of about 5.1 percent from the FY 2004 adjusted appropriation. The FY 2005 budget continues language for a number of programs which permit the appropriation of additional off-budget resources.

Off-Budget Items

The Department of the Treasury either collects and distributes, or has available to it for its own use, significant amounts of non-budgeted or off-budget revenue. According to the Governor's Budget, in FY 2005 these "other" funds are expected to total slightly more than $1.0 billion. "Other funds" include four types of non-budgeted resources: other distributed taxes, dedicated funds, revolving funds and miscellaneous funds.

The largest portion of this revenue, other distributed taxes, is appropriated by language and consists of taxes collected at the State level and distributed to local governments. In prior years, these taxes included the public utilities franchise and gross receipts taxes; under utility tax reform legislation enacted in 1997, this revenue is now drawn from taxes on the income and sales of various regulated utility companies. The FY 2005 budget proposes to distribute a total of $806.6 million collected from these energy replacement taxes. The Energy Tax Receipts are discussed in more detail in the State aid section which follows.

Other off-budget revenues fund programs from dedicated or special revenue funds, such as the Governor's Council on Alcoholism and Drug Abuse. The Governor's Council on Alcoholism and Drug Abuse is expected to generate $13.7 million in revenue in FY 2005. This amount will fully fund the initiatives of the council as well as programs within the Department of Health.

The final portion includes the various Treasury components that operate as revolving funds, with charges made directly against State agencies using their services. Among these units are OIT (which has been discussed earlier), the State Central Motor Pool, the Capital Post Office, the Print Shop and the Distribution Center. In FY 2005, a total of $184.4 million is recommended for the various revolving funds. This total represents a less than one percent decrease ($659,000) over the FY 2004 adjusted appropriation.

State Subsidies and Financial Aid

Over the years, the distribution of financial assistance to individuals and local governments has been the largest component of all Treasury expenditures. As the tables below illustrate, the Governor's FY 2005 Budget recommends $1.89 billion for these purposes, including $865 million in Grants-In-Aid to individuals and $1.025 billion in State aid to local government entities.

Grants-in-Aid

The three direct property tax relief programs budgeted and administered by the Department of the Treasury include: the Homestead Property Tax Rebates for Homeowners and Tenants program; NJ SAVER; and the Senior and Disabled Citizens' Property Tax Freeze program. The Executive FY 2005 Budget recommendation of $865 million in total funding for these programs is unchanged from the adjusted appropriation to the programs in FY 2004.

Program Description and Overview (Cont'd)

The Governor's budget recommends $517.7 million, the same amount as that of the FY 2004 adjusted appropriation, for distribution to qualified homeowners and tenants under the Homestead Property Tax Rebate Program (P.L. 1990, c.61). According to the "Budget in Brief", in FY 2005 this program will provide an estimated 1.6 million rebate checks to eligible homeowners and tenants, including seniors, the disabled, and persons with incomes not exceeding $100,000. Under proposed budget language, the maximum rebate amount for senior/disabled recipients will be $775, the same amount as in FY 2003 and FY 2004.

The Governor's budget recommends $299.6 million for the New Jersey School Assessment Valuation Exemption Relief (NJ SAVER) program, $25 million (7.7 percent) below the FY 2004 adjusted appropriation. NJ SAVER was enacted in 1999 to provide homeowners with direct property tax relief equal to a portion of the school taxes paid on the assessed value of eligible primary residences. Under a phase-in schedule, cut from five to four years' duration in 2001, payments in FY 2002 were made at 83 1/3 percent of the full amount, averaging $600, and slated to rise to 100 percent of the full amount in FY 2003. The FY 2003 Appropriations Act, however, included language continuing the rebates for that fiscal year at the prior year level. Language in the FY 2004 Appropriations Act reduced the payment level to 50 percent of that established in FY 2003 -- i.e., to 41.67 percent of the full amount, or an average payment of $250 -- and language recommended in the FY 2005 budget would maintain payments at this level for another year. In addition, the proposed budget continues the $200,000 annual income ceiling on eligibility for NJ SAVER payments that was imposed on program participants by budget language under the FY2003 and FY 2004 Appropriations Acts.

The FY 2005 budget recommends the appropriation of $48 million from the Property Tax Relief Fund for the Senior and Disabled Citizens' Property Tax Freeze program under P.L.1997, c.348, which reimburses certain low income senior and disabled residents for increases in property taxes on their homes. This funding level is increased by $25 million (108.7 percent) from the FY 2004 adjusted appropriation.

Table 1, which follows, lists the three grants-in-aid programs to individuals which are budgeted in the Department of the Treasury and shows funding for these program since FY 2003.

Table 1
Department of the Treasury
Grants-In-Aid To Individuals
FY 2003 - FY 2005
($000)

GRANTS-IN-AID	Expended FY 2003	Adj App FY 2004	Recom FY 2005
Homestead Rebates	$505,612	$517,663	$517,663
NJ SAVER	630,776	324,648	299,648
Senior and Disabled Citizens' Property Tax Freeze	22,106	23,000	48,000
Total, Grants-In-Aid	$1,158,494	$865,311	$865,311

Program Description and Overview (Cont'd)

State Aid

The Governor's Budget recommends almost $1.026 billion in State aid to municipalities and other local government entities. Table 2, which follows, lists the State aid programs in the Department of the Treasury and shows funding for these program since FY 2003.

The most significant State aid program is the Energy Tax Receipts distribution, an off-budget program whose distribution is authorized by budget language. This program, which distributes aid to municipalities from the State's taxation of certain regulated utilities as well as certain telecommunications companies, is recommended to increase by 3.3 percent to $787.7 million in FY 2005. Pursuant to P.L.1999, c.168, the amount credited to the Energy Tax Receipts Property Tax Relief Fund is adjusted annually by the rate of increase in the federally computed Implicit Price Deflator for State and Local Government Purchases.

The Governor's Budget recommends funding for Solid Waste Management - County Environmental Investment Debt Service Aid at $57.3 million. This program assists counties in paying debt service on their "stranded debt" for the construction of solid waste disposal facilities.

The Governor's Budget recommends $86 million for Veterans' Property Tax Deductions. The recommended appropriation constitutes an increase of $3 million (3.6 percent) over the FY 2004 adjusted appropriation.

Table 2, which follows, lists the State aid programs which are budgeted in the Department of the Treasury and shows funding for these program since FY 2003.

Table 2
Department of the Treasury
State Aid To Local Government Entities
FY 2003 - FY 2005
($000)

STATE AID	Expended FY 2003	Adj App FY 2004	Recom FY 2005
Energy Tax Receipts	$773,875	$762,739	$787,739
Municipal Reimbursement for Veteran's Tax Deductions	65,851	83,000	86,000
Municipal Reimbursement for Senior and Disabled Citizens' Tax Deductions	25,886	26,000	23,000
Solid Waste Management - Debt Service Aid	57,412	60,168	57,328
Debt Service - Pension Obligation Bonds	15,250	8,237	7,869
Police & Firemen's Retirement System - Post Retirement Medical	13,208	17,709	19,420
Police & Firemen's Retirement System	0	4,792	16,904

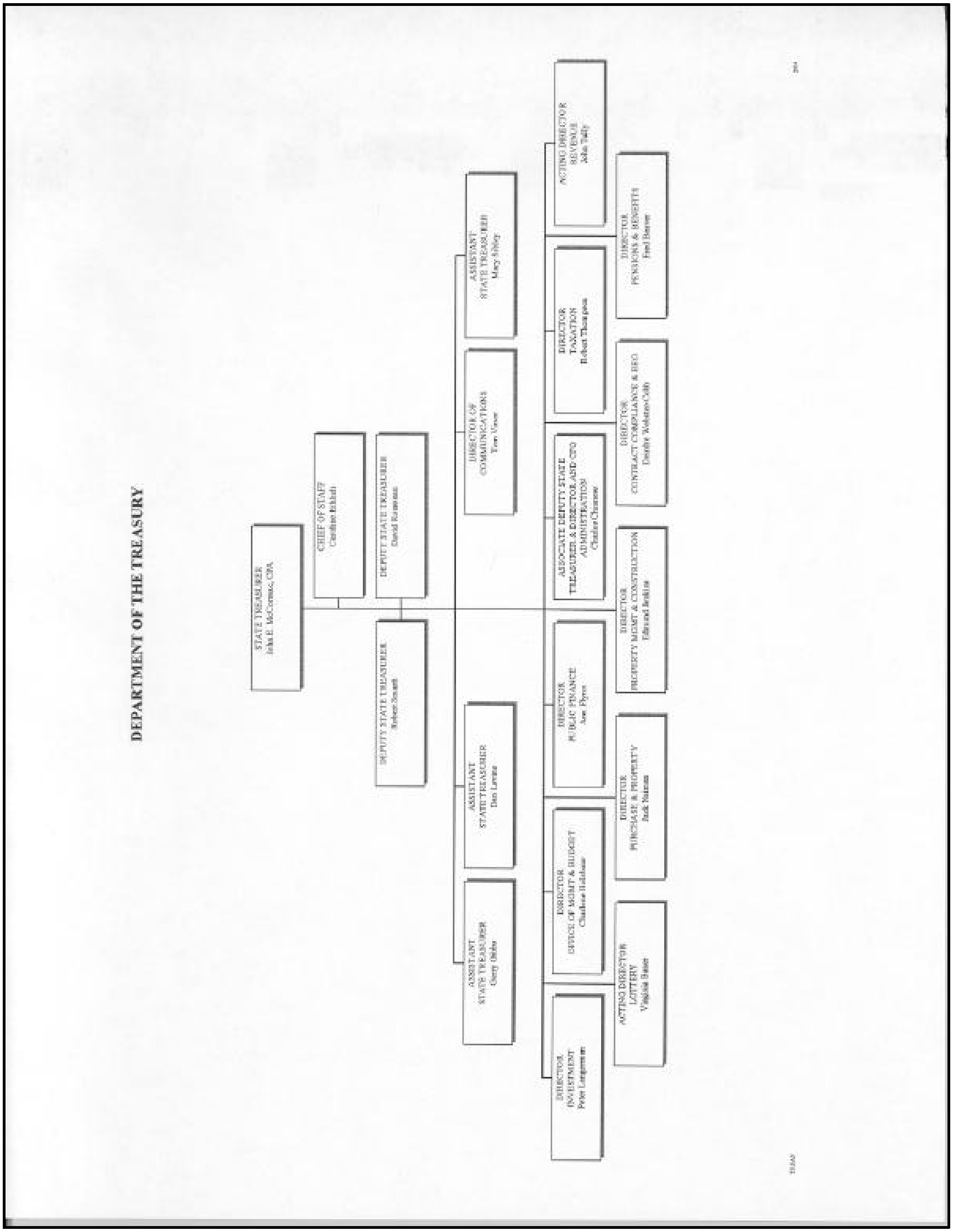
Program Description and Overview (Cont'd)

Police & Firemen's Retirement System (P.L. 1979, c. 109)	0	5,629	8,879
So. Jersey Port Corporation - Prop Tax Reserve Fund	2,000	2,000	2,442
So. Jersey Port Corporation - Debt Service Reserve Fund	3,127	4,200	4,200
County Tax Board Members	1,388	1,481	1,481
Camden Economic Recovery	0	1,500	0
Consolidated Police & Firemen's Pension Fund	2,714	1,951	7,046
Other Distributed Taxes	3,835	3,363	3,363
Total State Aid	$ 964,546	$ 982,769	$ 1,025,671
Grand Total: Grants-In-Aid and State Aid	$ 2,123,040	$ 1,848,080	$ 1,890,982

Personnel Changes

The Fiscal and Personnel Summary on page 26 of this report reflects the actual number of employees on the department's payroll at a given point in time for FY 2003 and FY 2004. The FY 2005 figures reflect the total number of positions to be funded without regard to vacancy status. In FY 2005, appropriations to the Department of the Treasury will fund a total of 6,714 positions. The actual payroll count in FY 2003 was 6,208.

Organization Chart



Fiscal and Personnel Summary

AGENCY FUNDING BY SOURCE OF FUNDS ($000)

	Expended FY 2003	Adj. Approp. FY 2004	Recom. FY 2005	Percent Change 2003-05	Percent Change 2004-05
General Fund					
Direct State Services	$388,558	$370,476	$351,598	(9.5)%	(5.1)%
Grants-In-Aid	181,929	211,022	228,011	25.3%	8.1%
State Aid	224,236	265,832	282,355	25.9%	6.2%
Capital Construction	10,014	0	0	(100.0)%	0.0%
Debt Service	353,552	374,428	381,265	7.8%	1.8%
Sub-Total	$1,158,289	$1,221,758	$1,243,229	7.3%	1.8%
Property Tax Relief Fund					
Direct State Services	$0	$0	$0	0.0%	0.0%
Grants-In-Aid	1,158,494	865,311	865,311	(25.3)%	0.0%
State Aid	142,990	159,808	164,334	14.9%	2.8%
Sub-Total	$1,301,484	$1,025,119	$1,029,645	(20.9)%	0.4%
Casino Revenue Fund	$34,669	$0	$0	(100.0)%	0.0%
Casino Control Fund	$25,674	$27,901	$27,901	8.7%	0.0%
State Total	$2,520,116	$2,274,778	$2,300,775	(8.7)%	1.1%
Federal Funds	$4,161	$4,076	$5,638	35.5%	38.3%
Other Funds	$1,038,583	$1,096,742	$1,085,682	4.5%	(1.0)%
Grand Total	$3,562,860	$3,375,596	$3,392,095	(4.8)%	0.5%

PERSONNEL SUMMARY - POSITIONS BY FUNDING SOURCE

	Actual FY 2003	Revised FY 2004	Funded FY 2005	Percent Change 2003-05	Percent Change 2004-05
State	4,532	4,604	4,908	8.3%	6.6%
Federal	13	16	22	69.2%	37.5%
All Other	1,663	1,728	1,784	7.3%	3.2%
Total Positions	6,208	6,348	6,714	8.2%	5.8%

FY 2003 (as of December) and revised FY 2004 (as of September) personnel data reflect actual payroll counts. FY 2005 data reflect the number of positions funded.

AFFIRMATIVE ACTION DATA

Total Minority Percent	22.1%	22.1%	22.3%	----	----

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

ECONOMIC REGULATION

BOARD OF PUBLIC UTILITIES AND THE RATEPAYER ADVOCATE

Federal Funds, Energy Resource Management	$2,025	$3,587	$1,562	77.1%	D-409

Four existing or new federal grants allocated to BPU are expected to increase in FY2005:

- *State Energy Conservation*, an increase of $745,000, from $1.5 million in FY2004 to $2.2 million in FY2005: The BPU's Bureau of Conservation and Renewable Energy utilizes these monies to encourage conservation through various residential and commercial energy programs, such as its ride sharing, lighting efficiency and improved construction standards programs.
- *Diamond Shamrock*, an increase of $117,000, from $500,000 in FY2004 to $617,000 in FY2005: These funds are provided from the Petroleum Overcharge Reimbursement Fund (PORF) representing settlements from the petroleum industry for pricing overcharges to consumers during the oil embargo in the 1970's, and are utilized by the BPU's Division of Energy for the support of administrative functions related to PORF compliance.
- *Industries of the Future*, a new $500,000 grant to be used to pursue federal (Department of Energy) industrial energy efficiency goals at the State level through a federal-State partnership targeting certain industries.
- New Jersey Clean Cities, a new $200,000 grant to raise awareness of clean energy among the State's municipalities.

Other Funds, Administration and Support Services	$0	$2,500	$2,500	—	D-409

The recommended amount represents estimated appropriated receipts from fines, penalties and settlements imposed upon utilities by the BPU for various violations. Authorization to appropriate these revenues is contained in proposed budget language. This language would allow the BPU, which is fully supported by an assessment on the industries it regulates, to augment its "on-budget" appropriation of $22.9 million with up to $3 million in "off budget" revenues without increasing its industry assessment. Absent this language, the revenues from fines and penalties imposed upon the industry would otherwise accrue to the General Fund.

FINANCIAL ADMINISTRATION

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

DIVISION OF TAXATION

Special Purpose: Property Assessment and Management Systems (PAMS)	$0	$1,175	$1,175	—	D-417

This Governor's Budget recommends a special purpose appropriation of $1.175 million for the Property Assessment Management System (PAMS) to revise the Division of Taxation's program for aggregating and analyzing local real property data that the State, county tax boards and municipal assessors use to generate tax lists, assessments, and various reports. The budget additionally recommends the continuation of existing carryforward language for PAMS which has been funded through either a line item appropriation or language since FY2001. Assuming approval of the Governor's FY2005 recommendations for this program, total funds available for PAMS over the current and next fiscal year will be approximately $11.8 million.

DIVISION OF REVENUE

General Fund, DSS Administration of State Revenues	$37,309	$27,819	($9,490)	(25.4)%	D-416

This recommended reduction for the Division of Revenue primarily reflects the elimination of FY 2004 supplemental appropriations totaling $8.25 million for various collection agency services. In addition, the division anticipates savings of $1.2 million from its "forms reduction initiative" which will lower "E-file" thresholds for employer and wage reports from 50 employees to 5 employees and require EFT submission of all unemployment and temporary disability contributions, and impose mandatory "E-file" and "E-pay" for certain categories of individual taxpayers, among other initiatives. As in past years, broad language is included in the FY 2005 Budget Recommendation to permit the appropriation of additional resources for the Division of Revenue without further legislative action.

Special Purpose: Wage Reporting/ Temporary Disability Insurance	$1,524	$899	($625)	(41.0)%	D-417

The recommended reduction in this special purpose account is a component of the "forms reduction initiative" described immediately above and accounts for about half of the estimated savings anticipated by the Division of Revenue from this initiative.

All Other Funds: Administration of State Revenues	$81,795	$38,795	($43,000)	(52.6)%	D-417

Of the recommended $43 million reduction in receipts from "Other" funds, $42 million is attributable to a shift in the way the Governor's Budget displays revenues realized by the newly

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

established New Jersey Public Records Preservation Account. On July 1, 2003 the Governor signed into law P.L. 2003, c.117, which increased the fees charged by county clerks and registers of deeds and mortgages for the filing of certain records and documents by $5. The statute also established the New Jersey Public Records Preservation Account in the Department of Treasury, into which revenues generated from the fee increases are deposited. Funds in the new account are dedicated for use by municipalities and counties (40 percent), and the Division of Archives and Records Management in the Department of State (60 percent) for the management, storage and preservation of public records.

In FY2004, $42 million of the total $70 million to be realized from the incremental fee increase was appropriated "off budget" as the State's share. Of this amount, $35.1 million was transferred to the Department of Education for additional Abbott v. Burke State Aid. For FY2005, the Governor's Budget anticipates a continuation level of receipts from these fees, of which $39 million of the State's $42 million share has been shifted "on-budget" as a Schedule 1 revenue (page C-17), while the balance, $3 million, is appropriated "off-budget" through proposed language within the Department of State.

GENERAL GOVERNMENT SERVICES

PURCHASING AND INVENTORY MANAGEMENT

General Fund, DSS Special Purpose: Fleet Renewal Management	$5,882	$560	($5,322)	(90.5)%	D-422

The recommended decrease in funding for Fleet Management reflects reduced line of credit costs associated with this program. Since FY1999, almost $50 million has been appropriated to this account as part of an initiative to replace aged vehicles in the State's fleet. During this time the average vehicle age has successfully been reduced from approximately eight years to roughly two to three years.

All Other Funds, Office of Information Technology	$0	$7,182	$7,182	—	D-423

The Governor's Budget recommends an "off-budget" appropriation of $7.182 million for outstanding requirements related to the Office of Information Technology (OIT) Availability and Recovery Site, or OARS project, a component of the Governor's security preparedness program which will establish a disaster recovery capability for all of OIT's processing services and data functions. Funding for OARS, which is a multi-year project estimated to cost about $13.3 million, had been had been included in the department's FY2005 Capital Budget request, but was not included in the Capital Recommendation. Pursuant to proposed language, the recommended off-budget source of funding for OARS will come from the dedication of up to $7.2 million in receipts from car rental surcharge receipts. The FY2005 appropriation is needed for "final construction and purchase of remaining hardware/software necessary to create the infrastructure for the Garden State Network and the backup and recovery of servers and the mainframe data."

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

STATE SUBSIDIES AND FINANCIAL AID

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page
PTRF, Grants-in-Aid: Senior and Disabled Citizens' Property Tax Freeze	$23,000	$48,000	$25,000	108.7%	D-428

The statute establishing this program was enacted in January 1998. The "base year" from which property tax increases reimbursable under the program are to be measured is property tax year 1997, or the tax year thereafter in which a claimant shall (have) become qualified. The first year for which reimbursements were made was property tax year 1998, and actual payments for 1998 (covering increases in property tax between 1997 and 1998) were made in July 1999. The adjusted appropriation in FY 2000 for those initial payments was $23.7 million, an amount that proved to be more than was necessary to cover the tax year 1998 payments. The adjusted appropriation amount in FY 2001 (for tax year 1999 payments) and FY 2002 (for tax year 2000 payments) was $10.6 million each year; as in FY 2000, the appropriation in both years exceeded program requirements, though by declining margins. Legislation enacted in October of 2001 expanded the class of persons entitled to "Freeze" reimbursement for that tax year by raising the income limits determining initial program qualification for base year 2000, thus increasing funding requirements for July payments under the program beginning in 2002. Accordingly, the appropriation for FY 2003 rose from prior fiscal years, ultimately to $23.1 million; all but $1 million of this amount was expended.

In FY 2004, the Appropriation Act included a language provision that (i) limited *eligibility for* a tax year 2002 Freeze reimbursement (payable in July 2003) to those otherwise qualified individuals who received a Freeze payment for tax year 2001, and (ii) limited the *amount of* that reimbursement to the amount received for that tax year. These limitations allowed funding for the program to be continued at $23 million.

The Executive Budget for FY 2005 recommends, in place of the language enacted for FY2004, language that (i) allows eligibility for the Freeze program to be determined in accordance with the program's statutory terms, but (ii) limits a claimant's reimbursement payment to the increase in the claimant's property tax between the base year and tax year 2002. The effect of this language change will be to bring Freeze reimbursements nearly into conformity with the program's statutory terms: only the statutory reimbursement for increases in tax year 2003 will go unpaid. Thus payments to pre-existing qualified claimants, and to claimants newly allowed to participate in the program, will be reduced by one year's reimbursement. Claimants who last year became eligible to use tax year 2002 as a "base year" and who would therefore become eligible under the basic law for reimbursement this year of any increase from 2002 to 2003 will not, as a result of the language, receive such a reimbursement.

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page
PTRF, Grants-in-Aid: NJ SAVER Program	$324,648	$299,468	($25,180)	(7.8)%	D-428

The Governor's budget recommends $299.6 million for the New Jersey School Assessment Valuation Exemption Relief (NJ SAVER) program, a decrease of $25 million (7.7 percent) below the

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

FY 2004 adjusted appropriation of $324.6 million. NJ SAVER was established under P.L.1999, c.63 to provide homeowners with direct relief equal to a portion of the school taxes paid on the assessed value of eligible primary residences. The budget proposal includes two provisions that would reduce FY 2005 payments under the program below the level to which they would otherwise have risen under the permanent law. First, whereas the authorizing legislation placed no income limit on eligibility for NJ SAVER payments, the FY 2004 Appropriations Act restricted eligibility to individuals and couples with annual income not exceeding $200,000, and the FY 2005 budget proposes to maintain that restriction. Second, the authorizing legislation provided for phased-in increases in payment levels provided under the program, with the full rebate amount to be payable starting in FY 2004. Under P.L.2001, c.106, the phase-in schedule was accelerated to make the full amount payable in FY 2003. The FY 2003 Appropriations Act, however, included language providing that rebates for that fiscal year would continue at the FY 2002 level (83 1/3 percent of the full amount). The FY 2004 Appropriations Act included language limiting payments in that fiscal year to 50 percent of the level of the prior year, or 41.67 percent of the full amount, and language retaining the limitation at this level is included in the budget recommendations for FY 2005. Payment of NJ SAVER rebates at the full statutory amount, even if limited to taxpayers with income not exceeding $200,000, would increase the cost of the program by about $420 million.

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page
General Fund, State Aid: South Jersey Port Corporation Property Tax Reserve Fund	$2,000	$2,442	$442	22.1%	D-428

The Property Tax Reserve Fund is the fund from which the Port Corporation makes payments in lieu of property taxes to Camden City and Camden County; for FY 2005, $2 million from the line item above represents funding for the in lieu payment to the City of Camden, while the remainder represents funding for the payment to Camden County. In FY 2004, the Camden County portion of the Corporation's in lieu of payment obligation was paid from other sources.

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page
PTRF, State Aid: Reimbursement to Municipalities -- Senior and Disabled Citizens' Tax Deductions	$26,000	$23,000	($3,000)	(11.5)%	D-429

The Executive budget recommends a total of $23 million in State Aid to reimburse municipalities for senior and disabled citizens property tax exemptions, a decline of $3 million (11.5 percent) from the FY 2004 adjusted appropriation. Funding requirements for the program are expected to resume the gradual decline of recent years, as fewer taxpayers or their surviving spouses establish or maintain eligibility.

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page
General Fund, State Aid: State Contribution to Consolidated Police and Firemen's Pension Fund	$1,951	$7,046	$5,095	261.1%	D-429

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

The CPFPF is funded on a reserve basis. Because it has no active members, it receives no employee contributions. The appropriation will meet the State's obligation for its portion of a deficiency that has arisen in the funding of the system's accrued liability. The deficiency is attributable primarily to the failure of fund assets (which are invested in short-term securities appropriate to the assumed life of the system) to achieve a return at the assumed rate of 8.75 percent. The actuary has adjusted the assumed return to 5 percent, which has resulted in the increase from FY 2004 in the actuarially prescribed contribution.

General Fund, State Aid: Police and Firemen's Retirement System	$4,792	$16,904	$12,112	252.8%	D-429
General Fund, State Aid: Police and Firemen's's Retirement System, P.L.1979, c.109	$5,629	$8,879	$3,250	57.7%	D-429

These line items represent the Executive's proposed FY 2005 funding of State Aid to meet the State's statutory obligation for part of the cost of providing benefits under the Police and Firemen's Retirement System (PFRS) to certain local government employees enrolled in that system. Under legislation enacted in 1997, certain assets of the PFRS were defined as "excess valuation assets" and could be used to offset the liability of PFRS employers for their normal contribution actuarially required to fund the system; the State was likewise able to offset its State Aid obligation for these items with those assets. By FY 2004, "excess valuation assets" in the several State-administered retirement systems had declined. The Administration proposed that the State's normal contribution to those systems in that year be funded at 20 percent of the actuarially prescribed level, with the funding effort to be increased over four fiscal years to reach 100 percent of the actuarially prescribed level in the fifth. The increases in the line items above result primarily from the reduced availability of "excess valuation assets" in PFRS to offset the State's contribution requirement, and from the increased funding effort in this, the second year of the five-year program.

PROTECTION OF CITIZENS' RIGHTS

General Fund, Grants-in-Aid: State Legal Services Office	$4,000	$6,000	$2,000	50.0%	D-436

The Governor's Budget recommends a $2.0 million increase in the annual grants-in-aid appropriation to Legal Services of New Jersey which provides free legal assistance in civil matters to individuals who cannot afford the cost of representation. According to the Administration and the State Legal Services office, this funding will partially offset an anticipated $4.4 million decrease in revenues available for the Legal Services program during calendar year 2004 from Interest on Lawyers' Trust Accounts, or IOLTA funds. This decrease in IOLTA, largely attributable to declining

Significant Changes/New Programs ($000)

Budget Item	Adj. Approp. FY 2004	Recomm. FY 2005	Dollar Change	Percent Change	Budget Page

bank account interest rates, represents about 12 percent of Legal Services' total current budget of approximately $38 million.

Historically, funding for Legal Services of New Jersey has come from three primary sources: the State of New Jersey (37%), IOLTA (38%), and the Federal government (15%) with a residual amount being provided through either county or private resources, including Legal Services' Campaign for Justice, United Way campaigns, bar association support and other gifts. Legal Services of New Jersey serves some 50,000 clients annually through six local field offices and the Statewide coordinating office in Edison.

Language Provisions

2004 Appropriations Handbook	2005 Budget Recommendations
	p. D-410
No comparable language.	Receipts derived from fines, penalties and settlements, not to exceed $3,000,000, are appropriated to supplement operating expenses of the Board of Public Utilities, subject to the approval of the Director of the Division of Budget and Accounting.

Explanation

The proposed language would permit the Board of Public Utilities (BPU) to supplement its on-budget appropriation of $22.9 million by up to $3 million from revenues derived from fines, penalties and settlements imposed upon utilities for various violations. This language would allow the BPU, which is fully supported by an assessment on the industries it regulates, to operate without increasing that assessment. Absent this language, the revenues from fines and penalties imposed upon the industry would otherwise accrue to the General Fund.

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-173	
Notwithstanding the provisions of any law or regulation to the contrary, any Pharmaceutical Assistance to the Aged and Disabled (PAAD) applicant found ineligible for the PAAD program solely because of the asset test, shall remain eligible to receive Lifeline Tenants or Credits Benefits.	No comparable language.

Explanation

The "Lifeline Credit Program," established pursuant to P.L.1979, c.197 (C.48:2-29.15 et seq.) and the "Tenants' Lifeline Assistance Program," established pursuant to P.L. 1981, c.210 (C.48:2-29.30 et seq.) provide utility assistance of $225 to individuals who meet Pharmaceutical Assistance to the Aged and Disabled (PAAD) eligibility requirements or who receive Supplemental Security Income (SSI). At the time the current budget was proposed, the Governor had recommended that an assets test be implemented as a means of reducing the cost of the PAAD program. An estimated 15,000 to 16,000 individuals who would be excluded from participation in the PAAD program solely because of the asset test would also have become ineligible for the Lifeline programs. The language in the FY2004 appropriation act was intended to ensure that these 15,000 to 16,000 individuals excluded from PAAD would continue to be eligible for assistance under the Lifeline programs. However, the concept of a PAAD asset test was ultimately abandoned, as its implementation proved more complicated than anticipated. Hence, the existing language is no longer needed.

Language Provisions

2004 Appropriations Handbook	2005 Budget Recommendations
	p. D-410
No comparable language.	The amounts appropriated hereinabove, not to exceed $70,840,000, for Payments for the Lifeline Credits and the Payments for Tenants' Assistance Rebates Programs are available to the Department of Health and Senior Services to fund the payments associated with the Lifeline Credits and Tenants' Assistance Programs and shall be applied in accordance with a Memorandum of Understanding between the President of the Board of Public Utilities and the Commissioner of the Department of Health and Senior Services, subject to the approval of the Director of the Division of Budget and Accounting.

Explanation

The proposed language reflects the reallocation, effective in the FY2004 budget, of the "Lifeline Credit Program" and the "Tenants' Lifeline Assistance Program" from the Department of Health and Senior Services (DHSS) to the Board of Public Utilities (BPU). However, as detailed in an October 2003 "Memorandum of Understanding" agreement between the BPU and DHSS, whereas the current Appropriations Act transferred responsibility for funding Lifeline energy assistance grants to the BPU, administration of these grants for purposes of "efficiency" remains with DHSS staff. Given this arrangement, it is necessary, as reflected in the proposed budget language, to transfer funds from the BPU to DHSS so that it can disburse grant payments to eligible recipients. As detailed last year, also beginning in FY2004, funding for the Lifeline programs, which was previously provided through the Casino Revenue Fund and "Other" (off-budget) resources, is provided through a new assessment on energy bills. The authority of the BPU to impose such an assessment was previously granted under the energy deregulation law, the "Electric Discount and Energy Competition Act, P.L.1999, c.23.

2004 Appropriations Handbook	2005 Budget Recommendations
	p. D-418

Language Provisions

2004 Appropriations Handbook	2005 Budget Recommendations
	Notwithstanding the provisions of section 4 of the "Lead Hazard Control Assistance Act," P.L.2003, c.311 such sums as are necessary are appropriated from the Lead Hazard Control Assistance Fund for the Department of Treasury's administrative costs, subject to the approval of the Director of the Division of Budget and Accounting.

Explanation

P.L.2003, c.311 established the "Lead Hazard Control Assistance Fund" (LHCAF) for the purpose of providing loans and grants to certain eligible homeowners for lead hazard control work. Among other sources, the LHCAF will be funded at a minimum of $7 million per year up to a maximum of $14 million per year, from a set-aside of sales tax revenue equal to $0.50 or the amount of sales tax collected from every retail sale of a container of paint or other surface coating material. The proposed language would provide for the reimbursement of any administrative costs incurred by the Division of Taxation in association with the allocation of a portion of such sales tax revenues into the LHCAF.

2004 Appropriations Handbook	2005 Budget Recommendations
	p. D-425
No comparable language.	Receipts derived from the agency surcharge on vehicle rentals pursuant to section 54 of P.L.2002, c.34 (C.App.A:9-78), not to exceed $7,182,000 for the Office of Information Technology Availability and Recovery Site (OARS), are appropriated and shall be deposited into a dedicated account, the expenditure of which shall be subject to the approval of the Director of the Division of Budget and Accounting.

Explanation

The proposed language would dedicate up to $7.2 million in car rental surcharge receipts to the Office of Information Technology (OIT) Availability and Recovery Site, or OARS project, a component of the Governor's security preparedness program, which is intended to establish a disaster recovery capability for all of OIT's processing services and data and telecommunications functions. Funding for OARS, which is a multi-year project estimated to cost about $13.3 million, had been requested (and previously funded) through the department's Capital Construction budget. The FY2003 budget provided an initial capital appropriation of $5.5 million for OARS, of which approximately half was unexpended and carried forward into the current budget year. The $7.2 million which would be provided off-budget through the recommended language had been

Language Provisions

included in the department's FY2005 Capital Budget request, but was not included in the Capital Recommendation. According to the request, "FY2005 capital funding is urgently needed for final construction and purchase of remaining hardware/software necessary to create the infrastructure for the Garden State Network and the backup and recovery of servers and the mainframe data."

OARS will be remotely located from existing OIT facilities in 11,000 square feet of space being developed and funded by the New Jersey Building Authority. At this location in Hamilton Township, OARS will provide redundant capacity for certain operations in the event that any of those operations, or access to certain facilities, is threatened with disruption (e.g., from terrorism or natural disaster). The essential functions intended to be served by OARS recovery are: (1) redundant operations of the Garden State Network, the infrastructure that supports State agencies' data processing functions, electronic interconnectivity among the agencies, and citizens' Internet access to agency services; (2) hundreds of critical applications related to the day-to-day responsibilities of 16 State agencies; (3) telecommunications, including all 800/900 service, voice mail and Emergency 9-1-1 systems; (4) maintenance and support of all computer infrastructure, including the States mainframe platform; (5) Public Information Officer functions, both internal and external; (6) computer output (printing of checks, documents, etc.); (7) the Local Area Network which serves the Riverview and State House Complexes; (8) Call Center/Help Desk functions.

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-181	
Of the unexpended balance as of June 30, 2003 in the South Jersey Port Corporation Debt Service Reserve Fund account, an amount not to exceed $2,000,000 is hereby appropriated for the South Jersey Port Corporation Retroactive PILOT Payment to the county of Camden.	No comparable language.

Explanation

The South Jersey Port Corporation was established under a 1968 law as an instrumentality of the State. To save the local jurisdictions included within the port district from loss of taxes on the corporation's real property, the law directed the corporation to make agreements with those jurisdictions to compensate them with reasonable payments in lieu of taxes ("PILOT payments"). Beginning in 1994, however, the State provided no funding for, and the corporation did not make, any PILOT payments to Camden County. In 2002, after extensive litigation initiated by the county, the port corporation reached an agreement with the county, settling its PILOT payment claims then outstanding for $4.3 million. Of this amount, $2.3 million was paid to the county in December 2002 from proceeds of a refinancing of the corporation's outstanding debt. The FY 2004 language cited above provided for payment of the remaining $2 million from the unexpended balance of a nondedicated account that received payments of the State's FY 2003 debt service appropriation to the corporation; the debt service payments for which the corporation originally requested these moneys to be appropriated were discharged through the refinancing. There has been no decision as to future PILOT payments by the corporation to Camden County.

Language Provisions

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-181	
The unexpended balance as of June 30, 2003 in the School Construction and Renovation Fund account is appropriated for the same purpose.	No comparable language.

Explanation

This language now appears in the budget for the Department of Education to reflect the reallocation of budgetary responsibility for the school construction program to that department from the Department of the Treasury.

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-181	p. D-430
There is appropriated from the Energy Tax Receipts Property Tax Relief Fund the sum of $762,739,000 and an amount to be determined by the Director of the Division of Budget and Accounting, which amount is transferred from the Consolidated Municipal Property Tax Relief Aid (PTRF) account to the fund, such that that amount when added to $762,739,000 shall equal the amount determined for fiscal year 2004 pursuant to subsection e. of P.L. 1997, c.167 (C.52:27D-439). The amount so transferred shall be allocated to municipalities in accordance with the provisions of subsection b. of section 2 of P.L. 1997, c.167 (C.52:27D-439). Each municipality that receives an allocation from the amount so transferred shall have its allocation from the Consolidated Municipal Property Tax Relief Aid program reduced by the same amount.	There is appropriated from the Energy Tax Receipts Property Tax Relief Fund the sum of $787,739,000 and an amount not to exceed $18,808,000 is transferred from the Consolidated Municipal Property Tax Relief Aid (PTRF) account to the fund and shall be allocated to municipalities in accordance with the provisions of subsection b. of section 2 of P.L. 1997, c.167 (C.52:27D-439). Each municipality that receives an allocation from the amount so transferred shall have its allocation from the Consolidated Municipal Property Tax Relief Aid program reduced by the same amount. Of the amount herein appropriated from the Energy Tax Receipts Property Tax Relief Fund, an amount equal to $25,000,000 shall be allocated to municipalities proportionately based on population, except that Newark and Jersey City shall each receive $390,000 of the $25,000,000 and Paterson shall receive $375,000 of the $25,000,000.

Explanation

The Energy Tax Receipts Property Tax Relief Fund (ETR Fund) was established under a 1997 law as an account through which receipts from certain "energy replacement taxes" under the energy tax reform program would be distributed to municipalities in lieu of payments out of collections under the old public utility gross receipts and franchise tax. The legislation directed that in each fiscal year, a prescribed sum from the replacement taxes should be credited to the ETR Fund for such

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distribution; failure in a given fiscal year to appropriate moneys in the prescribed amount would void taxpayers' liability for the new taxes for the appropriate tax year. Amendatory legislation enacted in 1999 specified that the funding requirement for the ETR Fund in FY 2002 would be $755 million and provided that thereafter, the requirement in each fiscal year would be equal to the requirement for the previous year plus an adjustment for inflation. Of the sum credited in FY 2003, the 2.5 percent inflation increase -- $18.875 million -- above the previous year's requirement of $755 million was, through a language provision, transferred to the Fund from the General Fund account from which Consolidated Municipal Property Tax Relief Aid (COMPTRA) is paid. Under similar language in the FY 2004 Appropriations Act, the amount credited that year to the ETR Fund from energy replacement taxes consisted of the FY 2002 base amount ($755 million) plus an adjustment for 2003-04 inflation of 1 percent applied to the FY 2003 base of $773.9 million ($7.739 million) -- a total of $762,739,000 -- while the remaining portion of the required funding, representing the $18.875 million adjustment for 2002-03 inflation, was transferred to the Fund from the COMPTRA account and deducted from municipal COMPTRA allocations.

The Executive's FY 2005 budget language recommendation would (i) continue funding through an offset against COMPTRA aid a portion of the total ETR Fund liability that closely approximates the inflation adjustment of FY 2002-03, but (ii) provide from the ETR additional funding ($25 million) that exceeds the roughly $19 million required by application of the annual inflation rate (2.5 percent) to the prior year obligation. The language incorporates a formula for distribution of the additional $25 million according to population with certain exemptions.

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-182	p. D-429
Notwithstanding the provisions of P.L. 1997, c.348 (C:54:4-8.67 et seq.) to the contrary, from the amount hereinabove only those claimants who received a Homestead Property Tax Reimbursement (Senior and Disabled Citizens' Property Tax Freeze) for tax year 2001, and do not exceed the income eligibility threshold limits for tax year 2002, shall be eligible to receive said reimbursement for tax year 2002, and any Homestead Property Tax Reimbursement (Senior and Disabled Citizens' Property Tax Freeze) issued for tax year 2002 shall not exceed the amount paid for tax year 2001.	The amount hereinabove for Homestead Property Tax Reimbursement (Senior and Disabled Citizens' Property Tax Freeze) is available to claimants eligible pursuant to provisions of P.L.1997, c.348, as amended by P.L.2001, c.251 (C:54:4-8.67 et seq.), only for Homestead Property Tax Reimbursements for property tax increases between a claimant's base year and tax year 2002.

Explanation

The FY 2004 Appropriation Act language (i) limited eligibility for a tax year 2002 Freeze reimbursement (payable in July 2003) to those otherwise qualified individuals who received a Freeze payment for tax year 2001, and (ii) limited the amount of that reimbursement to the amount received for that tax year. The Executive Budget for FY 2005 recommends, in place of that language, a provision that (i) allows eligibility for the Freeze program to be determined in accordance with the program's statutory terms, but (ii) limits a claimant's reimbursement payment to the increase in the claimant's property tax between the base year and tax year 2002. The effect

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of this language change will be to bring Freeze reimbursements nearly into conformity with the program's statutory terms: only the statutory reimbursement for increases in tax year 2003 will go unpaid. Thus payments to pre-existing qualified claimants, and to claimants newly allowed to participate in the program, will be reduced by one year's reimbursement.

2004 Appropriations Handbook

p. B-182

Notwithstanding the provisions of section 4 of P.L. 1999, c.63 (C.54:4-8.58b) to the contrary, no amount appropriated hereinabove for the NJ SAVER Program (PTRF) shall be used to pay a NJ SAVER rebate for claimants in a municipality in excess of 50% of the NJ SAVER rebate amount paid for the 2001 tax year for claimants in that municipality, or to pay a NJ SAVER rebate amount to any individual or married couple with gross income pursuant to N.J.S.54A:1-1 et seq. in excess of $200,000 for the 2002 taxable year. Provided however, that nothing herein shall limit the payment of an increased NJ SAVER rebate amount to a resident of a "qualified municipality," who has gross income not in excess of $200,000, as that increased NJ SAVER rebate amount may be provided for in section 20 of P.L.2002, c.43 (C:52:27BBB-20).

2005 Budget Recommendations

p. D-430

Notwithstanding the provisions of section 4 of P.L. 1999, c.63 (C.54:4-8.58b) to the contrary, no amount appropriated hereinabove for the NJ SAVER Program (PTRF) shall be used to pay a NJ SAVER rebate for claimants in a municipality which exceeds the NJ SAVER rebate amount paid for the 2002 tax year for claimants in that municipality, or to pay a NJ SAVER rebate amount to any individual or married couple with gross income pursuant to N.J.S.54A:1-1 et seq. in excess of $200,000 for the 2003 taxable year. Provided however, that nothing herein shall limit the payment of an increased NJ SAVER rebate amount to a resident of a "qualified municipality," who has gross income not in excess of $200,000, as that increased NJ SAVER rebate amount may be provided for in section 20 of P.L.2002, c.43 (C:52:27BBB-20).

Explanation

The proposed language for FY 2005 effectively provides for retention of the same limitations on income eligibility for, and the amount of, NJ SAVER rebate payments that were imposed under the cited language from the FY 2004 Appropriations Act.

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p. B-183

The unexpended balance as of June 30, 2003 in the Productivity and Efficiency Program is appropriated for the same purpose.

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No comparable language.

Explanation

A total of $11 million was appropriated to the Productivity and Efficiency Program in FY 1995 and

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FY 1996. These funds provided the State Treasurer with resources to encourage innovations in State government. They were used for various projects including an organizational and performance review of the Department of Corrections, a baseline and cost analysis of OTIS (the Office of Technology and Information Systems, or OIT's predecessor agency) and to fund the Unisys contract to modernize the Division of Taxation's tax processing equipment. Since FY1997, language has been included in each annual appropriations act permitting the unexpended funds from this account to carry forward. According to the OMB, this language is not recommended to continue in FY2005 as there is not expected to be any balance remaining by the end of the current year. According to NJCFS, the State's accounting system, as of May 4, 2004, the unexpended account balance is $26,293.

2004 Appropriations Handbook	2005 Budget Recommendations
	p. D-433
No comparable language.	There is appropriated from revenue estimated to be received as a fee in connection with the issuance of debt an amount not to exceed $700,000 to provide funds for public finance activities.

Explanation

The operations of the Office of Public Finance, which oversees the issuance of State debt, are supported by off-budget revenue sources. According to the Treasurer's Office, in the current and prior fiscal years, the operations of this office were funded utilizing an advance from investment earnings which were subsequently reimbursed from bond proceeds. The proposed language would eliminate this practice of advancing investment earnings for this purpose and instead recognize and appropriate those estimated receipts of $700,000 anticipated from the fees realized from various State agencies for cost of bond issuance.

2004 Appropriations Handbook	2005 Budget Recommendations
p. B-183	p. D-433

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2004 Appropriations Handbook	2005 Budget Recommendations
Pursuant to the provisions of P.L.1999, c.12 (C.54A:9-25.12 et seq.) deposits made to the "Drug Abuse Education Fund" and the unexpended balance as of June 30, 2003 of such deposits are appropriated for collection or administration costs of the Department of Treasury and for transfer to the Department of Education such sums as are necessary for program costs and grants, subject to the approval of the Director of the Division of Budget and Accounting.	Pursuant to the provisions of P.L.1999, c.12 (C.54A:9-25.12 et seq.) deposits made to the "Drug Abuse Education Fund" and the unexpended balance as of June 30, <u>2004</u> of such deposits are appropriated for collection or administration costs of the Department of the Treasury and for transfer to the Department of Education <u>such sums as are necessary</u> for <u>Project DARE (Drug Abuse Resistance Education)</u>, subject to the approval of the Director of the Division of Budget and Accounting.

Explanation

The proposed changes to the existing language are not substantive; however, the language modification clarifies that funds transferred to the Department of Education from the "Drug Abuse Education Fund" are for the specific support of Project DARE.

P.L.1999, c.12 created the "Drug Abuse Education Fund" within the Department of the Treasury and established a tax return "check-off" opportunity for taxpayers on their New Jersey gross income tax return to enable taxpayers to direct a portion of their tax refund be deposited in the special fund. (Contributions by taxpayers who are not due refunds are also permitted through the enclosure of a donation when the tax return is filed.) This law further established that all contributions and deposits into the fund be distributed by the Department of Education to non-governmental entities operating in the public interest that, utilizing law enforcement personnel, provide drug abuse education programs on a State-wide basis, such as, but not limited to, Project DARE (Drug Abuse Resistance Education). However, to date, Project DARE has been the sole beneficiary of monies into the fund.

Discussion Points (Cont'd)

1. The Governor's FY2005 Budget recommendation anticipates $1.52 billion from "new revenue securitizations." According to the Budget in Brief, the amount to be securitized would be supported by revenue from the proposed increase in the cigarette tax, which is projected to generate $135 million annually, and from new and increased motor vehicle surcharges, which are estimated to raise $50 million annually.

- *Questions:* What are the expected terms of the proposed issuance? Specifically: What is the anticipated length of the scheduled repayment? Will the amortization schedule be flat or increasing? How large will the last year's payment be relative to the first year's payment? What are the anticipated total debt service costs of the issuance for principal and for interest?

  How much of the $185 million anticipated annually from incremental cigarette tax and motor vehicle surcharge revenues will be used to support this issuance? Please provide this information for each fiscal year over the expected term of the issuance.

  Excluding the securitization of tobacco settlement monies, have any other states securitized annual tax or fee-generated revenues to support current operating expenses?

  Please explain why the $1.52 billion revenue anticipation should not, as suggested by certain rating agencies, be considered deficit financing in the current year.

  Given that this $1.52 billion revenue line item represents the sixth largest revenue source supporting the FY2005 State budget, how does the Administration anticipate resolving the apparent structural budget gap in future years?

2a. Last September 18, Independent Fiduciary Services, Inc. (IFS), a firm that the State Treasurer had retained to conduct an "operational review" of the Division of Investment delivered its final report. In that report, IFS offered some 79 recommendations designed to enhance the operations and performance of the division, of which 32 recommendations were accorded "high" priority by IFS, including the following:

- That the Division hire additional staff or, insofar as feasible, reassign some current personnel to fortify . . . understaffed functions.
- That the Division obtain an automated trade order management system with pre- and post-trade compliance capabilities.
- (That the Division require) prospective and existing service providers to disclose when they provide financial support within the relevant past to governmental officials or campaigns of announced candidates for elective public office with a direct or indirect material influence over the Division's investment programs.
- That the Division seek to implement electronic processes designed to facilitate straight-through-processing of trades.
- That the (State Investment) Council approve investment in additional asset classes and strategies in order to achieve better diversification.
- That as the (investment officers) consider how best to enhance the investment program, including investing in additional asset classes, they should utilize external investment management where the Division lacks sufficient resources or expertise to effectively internally manage assets.

Discussion Points (Cont'd)

- *Question:* Which of these high priority recommendations, if any, has the department determined to implement, and what steps have been taken or planned toward such implementation? What additional IFS recommendations, if any, has or does the department plan to implement?

2b. As outlined in the OLS background paper beginning on page xx of this report, according to IFS, the Division of Investment lacks the in-house expertise to execute investments in certain recommended new asset classes, and would therefore likely have to seek such competency elsewhere for an immediate implementation of this advice. Moreover, IFS noted that the creation of internal investment teams would require time and the hiring of additional investment analysts. Because the consultants deemed the division's compensation schedule insufficiently competitive, IFS doubted that the division could acquire an adequate level of talent without significantly boosting its pay scale. Consequently, IFS proposed the hiring of external money managers to make nontraditional investment decisions.

An April 19, 2004 *Trenton Times* article indicated that the State Investment Council "eventually expects to put about 7.5 percent of the $68 billion pension portfolio into hedge funds, venture capital and real assets such as land, timber and oil." A second consultant, Strategic Investments Solutions, has been retained to advise the State as it implements an alternative investment strategy.

- *Questions:* Please discuss the department's plans for implementing an alternative investment program. What, if any, steps regarding this overall recommendation have been taken to date?

  To what degree will the recommendation to invest in new asset classes be implemented through the enhancement of current in-house staff? Please analyze and provide comparative data showing the projected cost *to the pension fund system* of hiring additional in-house staff with the appropriate expertise to implement an alternative strategy versus the estimated cost of hiring external managers.

  Does the department anticipate seeking statutory revisions that may be required in order to hire external managers? If so, when should the Legislature anticipate this proposal? If not, under what legal authority does the department believe it is authorized to pursue the hiring of such managers?

3a. The statutory provisions of the Business Employment Incentive Program, which provides grants to businesses that create new jobs in this State, were significantly revised last year pursuant to P.L.2003, c.166. Three key amendments to the program were:

- <u>A reduction in the minimum number of new jobs required to be created by a grant recipient.</u> Whereas BEIP originally required a recipient to create 25 new jobs in an urban area or 75 jobs in a non-urban area to be eligible for a grant, the revised law established a new threshold of 25 jobs at any site in New Jersey, or 10 jobs for companies specializing in certain high technologies.
- <u>The establishment of "residual withholdings</u>" which in rough terms is the residual income tax withholding from new jobs after the payment of program grants. The law gives NJEDA the discretion to anticipate, bond for, and utilize these funds for unspecified investment assistance programs for certain small and medium-size businesses.
- <u>Expansion of the job creation threshold to include new jobs located in this State but filled by certain non-State residents.</u> In contrast to the original program, the revised law allows new jobs created by a grant recipient, but filled by residents of Pennsylvania (for whom

Discussion Points (Cont'd)

a New Jersey employer pays no withholding taxes under a bi-state reciprocity agreement) to count toward a grantee's job creation eligibility requirement.

- *Questions:* How has each of these changes affected the program? Please provide data which show the average number of new jobs created by a grant recipient under the revised job creation requirements compared to the number created under the program's original thresholds. What is the average (dollar value of a) grant award per new job created under the revised requirements compared to the original job creation threshold(s)?

  Please indicate the annual total dollar value for the next ten years of any residual withholdings the NJEDA is currently anticipating, as well as the amount assumed in any bond issuance(s) or planned issuance(s). Please specify how the agency has utilized or plans to utilize these residual withholdings.

  Please provide a listing of all BEIP grant recipients who have qualified for a grant based on new jobs held by non-State residents which shows for *each* grant award: the name and location of the grantee, the total number of new jobs created in this State, the total number of new jobs held by non-State residents, and the amount of the grant award.

  For the BEIP program since inception, please provide (preferably in electronic, *non-PDF format*) an up-to-date report which shows for *each* grant award: the name, location, and industry of the grantee; the total number of new jobs anticipated, the total number of jobs created to date, the total amount of the grant award, and the grant amount disbursed to date.

3b. The statute establishing the Business Employment Incentive Program, P.L.1996, c. 26 (C.34:1B-124 et seq.) requires that "After the program's fifth year, the department (Commerce), *in conjunction with the State Treasurer*, shall assess the effectiveness of the program in creating new jobs in New Jersey and the impact on State revenues." In response to this same question posed by OLS last year, the department indicated that although the Treasurer and Commerce Secretary had appointed a study commission to examine BEIP, no date for preparation and delivery of the required report had yet been established.

- *Question:* What is the status of this report? When will a final report be delivered to the Legislature? Who are the members that have been appointed to the study commission? Please provide a summary of the study commission's preliminary findings, if any, and the methodology being used to assess the program's effectiveness.

4. The Board of Public Utilities, an agency in but not of Treasury, is fully funded by assessments on the industries it regulates. Proposed language (page D-410) would allow the BPU to supplement its operating budget by up to $3 million utilizing revenues generated from fines and penalties imposed on utilities for various violations. This language would allow the BPU to operate without increasing its industry assessment. Without this language revenues from fines and penalties imposed upon the industry would otherwise accrue to the General Fund.

- *Question:* Please explain the recommended utilization of revenue from fines and penalties paid by utilities for various violations as an offset to the assessment these same utilities pay to support the operating expenses of the BPU. In other words, are not these fines and penalties on the industry going to benefit the industry?

Discussion Points (Cont'd)

For the five most recent fiscal years, please indicate the annual percentage rate change in the assessment imposed on utilities for the support of the BPU.

5. Through its Law Guardian program, the Office of the Public Defender (OPD) provides statutorily mandated representation to children who are abused and neglected (Title 9 proceedings) and in termination of parental rights cases (Title 30 proceedings). Additionally, through its Parental Representation Unit, the OPD also provides mandated representation to indigent parents for these same types (Title 9 and Title 30) of actions.

In accordance with the goals of the Child Welfare Reform plan, which would dramatically reduce caseloads within the Division of Youth and Family Services, the Governor's Budget proposal includes language permitting the transfer of up to $15.8 million to the OPD and the Department of Law and Public Safety for the addition of some 220 positions to "speed children's cases to court." According to OPD's budget request, this funding will add additional Law Guardians and support staff which will reduce attorney caseloads and court backlogs with respect to both Title 9 and Title 30 proceedings.

- *Questions:* Please provide an overview of OPD's plans for implementing its additional responsibilities under the Child Welfare Reform Plan. Please additionally discuss how the reform plan will substantively change the current processes of the Law Guardian and Parental Representation units.

  How much of the proposed $15.8 million in additional funding does OPD anticipate and how will this money be expended? Please include in your response a schedule showing when additional staff are expected to be hired. What are the anticipated short and long-term impacts of the reform plan on OPD caseloads?

6. The "Casino Reinvestment Development Authority (CRDA) Urban Revitalization Program," P.L.2001, c.221, was enacted to provide grants to casino licensees for the development of up to six entertainment-retail districts in Atlantic City; in the absence of a sufficient number of district projects by casino licensees, the law authorized CRDA to undertake such projects.

The law established two funds to provide incentive grants to licensees: (1) a "project fund" consisting of all sales and use tax receipts from (a) the taxation of construction materials used for building an approved district project, and (b) retail sales of tangible personal property originating and delivered from business locations in a district project; and (2) a "room fund" comprising all revenues received from the hotel use fees (equal to $2 per day per occupied room) from certain facilities/properties.

In order to be eligible for a grant, a licensee must allocate a minimum of $20 million to certain projects in urban areas outside of Atlantic City, with a certain percentage to be expended in "South Jersey" and "North Jersey." The monies set aside under this program are not an up-front cash payment, but a long-term investment obligation on the part of the casinos to be paid over the next 10 to 15 years.

A recent report in the *Press of Atlantic City* indicated that although the amount of redevelopment revenue anticipated by CRDA in 2004 is expected to reach $70 - 80 million, this revenue stream "has been mortgaged well into the future" by current project commitments.

- Questions: Please detail the six Atlantic City projects undertaken or planned as a result of the 2001 enactment, including for each: a description of the project; the name of the licensee undertaking the project; and the total amount to be invested. In addition, please indicate the commitment each licensee has made towards projects outside of

Discussion Points (Cont'd)

Atlantic City. For each fiscal year since inception, how much has been deposited in the project fund? the room fund? Please also provide a listing of all of the projects CRDA has approved outside of Atlantic City, including for each a description of the project, its location, and the dollar amount of the program grant award. Please discuss, with as much specificity as can be provided, the availability, or lack thereof, of revenue for projects outside of Atlantic City in future years.

7a. Under the State's Earned Income Credit (EIC) program, P.L.2000, c.80 (C.54A:4-6 et seq.), New Jersey families with gross incomes of $20,000 or less, who receive a federal Earned Income Tax Credit, are eligible for a refundable New Jersey EIC equal to 20% percent of the family's federal credit.

At the time that the EIC program was enacted, it was anticipated that under federal rules for the Temporary Assistance to Needy Families (TANF) program, created by the Welfare Reform Law of 1996, the refundable portion of EIC could be financed with federal TANF funds, or with the "maintenance of effort" (MOE) funds states must spend to access the federal TANF funds. Moreover, it was noted that a taxpayer who receives a refundable credit need not be a welfare recipient or meet the State's welfare eligibility requirements for this provision to hold, since federal law only requires TANF and MOE funds to be spent on "needy" families, a definition determined by the State. In the first years of the EIC program, roughly 70 percent of the program's total cost has been covered by TANF funds; however, indications are that significantly fewer TANF dollars will be available for this purpose in FY2005 and beyond.

- Questions: For each fiscal year since inception, please report the actual total cost of the EIC program and the proportion covered by federal TANF monies versus the Property Tax Relief or General Funds. Please estimate this same data for FY2004 and FY2005.

7b. According to Internal Revenue Service Statistics of Income data, 452,848 New Jersey families received benefits under the federal Earned Income Tax Credit (EITC) in Tax Year 2001. Of that amount, approximately 329,540 (73 percent) had incomes below $20,000. At the time of enactment, the experience of other states' EIC programs suggested that New Jersey would eventually realize a participation rate equal to 85 percent of the federal program. According to State Statistics of Income (SOI) data for Tax Year 2001, approximately 198,700 taxpayers, or about 60% of the number of federal recipients earning $20,000 or less, claimed the EIC.

- *Questions*: Why is our participation rate lower than expected? Please describe what efforts are underway to maximize the number of eligible taxpayers claiming the EIC. Please provide any preliminary NJSOI data that exist for TY2002 with regard to the EIC.

8. The Governor's Budget recommends a Special Purpose appropriation of $1.175 million for the Property Assessment Management System (PAMS), which seeks to revise the Division of Taxation's program for aggregating and analyzing local real property data that the State, county tax boards and municipal assessors use to generate tax lists, assessments, and various reports. The budget additionally recommends the continuation of existing carryforward language for PAMS which has been funded through either a line item appropriation or language since FY2001. Assuming approval of the Governor's FY2005 recommendations for this program, total funds available for PAMS over the current and next fiscal year will be approximately $11.8 million.

- Questions: What is the status of the PAMS project? Please detail the delays in

Discussion Points (Cont'd)

implementing PAMS, and provide a projected date of completion and estimate the project's total cost. Please give specific examples of the system's planned applications and indicate whether non-State governmental entities will have access to its database on a request or other basis.

9. The Governor's budget continues language appropriating an amount not to exceed $12 million for a "re-engineering of the pension and health benefits computer systems as referenced in the Division of Pensions and Benefits organizational study," subject to reimbursement of the General Fund by pension fund resources. This initiative, which calls for a complete replacement of all Pension and Benefits application software was previously projected to cost approximately $51.4 million over five years.

- Question: Please provide an update of the "re-engineering" project, including its scope, total cost, and time frame for completion. Please provide a summary of costs incurred to date, by fiscal year, for this project. Have the expenditures incurred thus far by the General Fund been charged back to the pension systems?

10. The homestead property tax reimbursement program, sometimes known as the Senior and Disabled Citizens' Property Tax Freeze (or simply "Freeze") program, is designed to provide qualified senior and disabled homeowners a reimbursement of any annual increase in property taxes above the amount of the tax liability for the "base year" in which the homeowner became eligible for the program.

In FY2004, a year of fiscal constraint, the Governor proposed and the Legislature included in the Appropriations Act a language provision that (i) limited *eligibility for* a tax year 2002 Freeze reimbursement (payable in July 2003) to those otherwise qualified individuals who received a Freeze payment for tax year 2001, and (ii) limited the *amount of* that TY2002 reimbursement to the amount received for the earlier tax year. This "freeze" of both the pool of reimbursement recipients and the amount each received enabled funding for the program to be continued at $23 million.

The Governor's Budget for FY2005 recommends, in place of the language enacted for FY2004, language that (i) allows eligibility for the Freeze program to be determined in accordance with the program's statutory terms, but (ii) limits a claimant's reimbursement payment to the increase in the claimant's property tax between the base year and tax year 2002. Under this language, claimants who last year received Freeze payments for tax year 2002 that were limited to the amount paid a year earlier for tax year 2001 will get a higher payment this year, but this higher payment will not -- contrary to the provisions of the Freeze statute -- reflect the change in a claimant's property tax bill between tax years 2002 and 2003; rather, the reimbursement increase will reflect the 2001-02 property tax increase. First-time claimants who, but for the FY2004 eligibility limitation, would have become eligible for a payment last year (i.e., had become qualified the previous year to use tax year 2001 as a "base year") will now receive a payment, but only for the 2001-02 increase in their property tax, rather than for the full amount of the increase between 2001 and 2003 for which they are eligible under the Freeze statute. Claimants who last year became eligible to use tax year 2002 as a "base year" and who would otherwise become eligible for reimbursement of any increase from 2002 to 2003 will, under the language, be denied any payment.

According to the "Budget in Brief" for FY2005, about 130,000 Freeze program participants will receive property tax reimbursements in the fiscal year, and the average reimbursement for the year will increase to $430 from $212 in FY2004. The line item amount recommended for the program in FY2005 is $48 million.

- *Questions:* If Senior and Disabled Citizens' Property Tax Freeze reimbursements

Discussion Points (Cont'd)

for tax year 2003 were to be paid in full accordance with the provisions of P.L.1997, c.348 as amended, how many additional taxpayers would be eligible for such reimbursements? For taxpayers entitled to reimbursement payments under the proposed FY2005 language provision described above, how much would their average reimbursement increase if paid in full accordance with the statute? For taxpayers denied eligibility under the proposed language, what would their average reimbursement payment be if they were not denied eligibility? Since the funding requirement for 130,000 payments averaging $430 each ($55.9 million) exceeds the amount of the line item recommendation, is it expected that a supplemental appropriation may be required during FY2005?

11. As in past years, the Governor's budget proposal includes language appropriating, as General Fund State aid for allocation to municipalities, moneys from the Energy Tax Receipts Property Tax Relief Fund, including moneys transferred to that Fund from the Consolidated Municipal Property Tax Relief Aid account in the PTRF. This allocation is to be made in accordance with P.L.1997, c.167, which established the program for replacement of municipal aid previously paid from proceeds of the public utilities franchise and gross receipts taxes. The proposed language for FY2005, however, makes a special allocation, from the total amount appropriated, of $25 million on the basis of population; an exception to this formula allocation of the $25 million is made for Newark, Jersey City and Paterson, to which specific amounts are allocated.

- *Questions:* What budgetary or policy purpose will be served by using a population-based formula to allocate $25 million of Energy Tax Receipts replacement aid in FY2005? Will use of the specific allocations to Newark, Jersey City and Paterson reduce the portion of the $25 million that any of those cities receives below the amount that it would have received under the population-based formula applicable to other municipalities? If so, what is the amount of that reduction? What factors or considerations justify the recommendation to curtail entitlements for only those three municipalities? Please identify, for each municipality expected to receive replacement aid under the language provision, the total FY2005 amount of such aid that the municipality would receive (i) if the language provision of the budget proposal is adopted as recommended, (ii) if the entire $25 million amount referred to in that language provision were allocated solely on the basis of population, and (iii) if, in accordance with the provisions of P.L.1997, c.167, the $25 million were allocated as part of the entire amount of the appropriated funds.

12. The FY2004 Appropriations Act included language appropriating General Fund State aid, in an amount not to exceed $1.5 million, for "expenses associated with municipal economic recovery efforts as determined by the chair of the Economic Recovery Board for Camden . . . ." Identical language is included in the Governor's FY2005 budget proposal.

- *Questions:* Is this appropriation expected to be made annually in the future, and if so, why is it placed "off-budget?" If this appropriation is expected to be on-going, for how many years beyond FY2005 will it be required? What specific expenses associated with the municipal economic recovery efforts in Camden is this appropriation being used to support?

13. The Governor's FY2005 budget proposal for the department recommends General Fund State aid appropriations to the Police and Firemen's Retirement System (PFRS) in the amounts

Discussion Points (Cont'd)

of: (i) $8.9 million to cover the State's liability for a portion of the cost of the increase in the PFRS special retirement ("25-and-out") benefit under P.L.1979, c.109; and (ii) $16.9 million to cover the State's liability for funding the increase in local employers' costs resulting from the transfer of employees from the Public Employees' Retirement System to PFRS under P.L.1993, c.247, and from the enhancement of the benefit to widows of PFRS retirees under P.L.1991, c.511. Like the normal contribution payable by PFRS employers generally, the amount of the liability for these payments is based upon the system's reserve funding program. The liability of these employers is partially offset through the application of "excess valuation assets", as defined under amendments to the PFRS statute enacted in 1997.

In FY2004, the State's normal contributions to the several State-administered retirement systems were funded at only 20% of the actuarially prescribed level, leaving 80% of its obligation unfunded. At that time, the Administration declared its intention to reduce the unfunded portion of the annual obligation by 20% a year with full funding being reached in FY2008.

- *Questions:* What is the total amount of excess valuation assets allocable to PFRS employers other than the State for the valuation period ending June 30, 2003? What amount of those excess valuation assets, if any, is available under N.J.S.A.43:16A-15 to reduce the normal contribution of those employers in FY2005, and how much of that amount will be applied to reduce the State's statutorily prescribed contribution for the line items referred to above? What amounts have been certified by the actuary as required to fund the normal cost and unfunded actuarial accrued liability (UAAL) cost to the State in FY2005 for those line items, and what percentage(s) of the FY2005 full funding obligation for these line items do the recommended appropriation amounts represent? With respect to these line items only, what will be the amount of the unfunded actuarial accrued liability resulting from the underfunding in FY2004 and FY2005? At what level is it anticipated that the actuarially certified normal and UAAL contribution will be funded in FY2006? In FY2007? In FY2008?

14. The Governor's FY2005 budget proposes Homestead Rebate program funding of $517.7 million affecting about 1.6 million homeowners and tenants with incomes below $100,000. The NJ SAVER program is supposed to pay $300.0 million to over 1.1 million households with incomes below $200,000. Under current law, recipients receive the greater amount under either program. Some taxpayers may receive two checks depending on whether or not their NJ SAVER amount is greater than their Homestead Rebate amount.

Questions: Please provide information for the last five fiscal years regarding recipients who receive both Homestead Rebate checks and NJ SAVER checks. How many households are affected? How much money do these households receive from each program? What is the average check under each program? Please provide this data for the whole population, and for sub-categories of senior/disabled recipients, non-senior/ disabled recipients, tenants, and non-tenants.

Please provide, in an electronic spreadsheet file format, the total dollar amount paid and the number of recipients by municipality for each of the three most recent years for the Homestead Rebate program and the NJ SAVER program. (Please include the municipality codes with the data.)

15. Several relatively recent news releases issued by the State Treasurer's Office highlight arrests related to the smuggling, trafficking and/or sale of contraband cigarettes. The New Jersey

Discussion Points (Cont'd)

Division of Taxation's Office of Criminal Investigation is responsible for the investigation of alleged criminal violations of the New Jersey Cigarette Tax Act and other State tax laws.

- Question: Please discuss the division's observations and experience concerning the number of violations and the magnitude of tax avoidance activity related to cigarettes since FY2002, the year prior to recent increases in the excise tax on cigarettes.

Background Paper: Pension Fund System Performance Issues

Budget Pages.... D-416 to D-419

From June 30, 2000 to June 30, 2002, the value of the assets in the New Jersey public pension fund system dropped from $82.6 billion to $63.3 billion. In response to those losses, the Administration has undertaken numerous initiatives designed to bolster the system's future performance. To that end, it had also commissioned an outside review of the operations of the Division of Investment, the administrative entity within the Department of the Treasury directing the pension system's investments. In September 2003, Independent Fiduciary Services (IFS) released its report. Of its suggestions, the most publicly noted has been the recommendation to hire private money managers who would direct investments in new asset classes, in an effort to moderate asset value fluctuations and boost investment earnings through a more diversified portfolio.

In this background paper, OLS will review the system's volatile performance over the last ten years, before discussing its implications for long-term earnings and State budgeting. Next, OLS will present IFS' proposal to stabilize annual returns by including new asset classes in the system's holdings. Finally, it will explore the rationale behind IFS' suggestion to hire private money managers as well as concerns related thereto.

THE VOLATILITY OF PENSION SYSTEM RETURNS

As the figures in the table on the next page illustrate, the pension system's performance over the last ten completed fiscal years tells the story of annual returns that have been significantly more volatile than those of selected public pension funds and the median public pension fund. Whereas New Jersey's annualized investment rate of return fell significantly below the median in the latter half of the last ten years, its ten-year equivalent still surpasses it, thereby implying solid above-average rates of return in the earlier half of the ten-year horizon. Albeit canceling each other out over the ten-year period, these sharp fluctuations may have adverse effects.

The system's relatively high volatility of returns has curtailed its market value. As long as period-to-period volatility operates in the same direction, it is uninteresting. Whenever portfolio performance vacillates between gains and losses, on the contrary, variability hampers the system's long-term growth potential. The effects of compounding allow for a portfolio with sporadic period-to-period losses to be outperformed by a less variable portfolio with the same average annual rate of return but fewer negative periods.

For example, if an investment loses 50 percent of its $100 value in the first year (down to a $50 value) and follows up that loss with a 50 percent gain (up to a $75 value), its average annual rate of return will be 0 percent, although it will have lost 25 percent of its value (or $25). Stable returns of 0 percent would have also produced an average annual rate of return of 0 percent, but the portfolio would still be worth $100, and hence in a better position for future growth. *Annualized returns, as used in the table on the next page, account for compounding.* The investment with a 0 percent average rate of return but a combined 25 percent loss in market value has an annualized rate of return of negative 13.4 percent, while the annualized rate of return of the stable investment is 0 percent.

Apart from lowering a portfolio's long-run market value, volatility can mislead investors

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during periods of extreme returns. Within the context of a public pension fund, volatility can also impact a governmental entity's annual finances. Following substantial multi-year gains, governments might mistake the boom years as new normalcy, and accordingly deem their pension fund to be able to afford an upgrade in pension benefits. To sustain the additional commitments, though, the portfolio is required to augment its long-term average growth rate above its existing average long-term growth trends. If returns revert to previous "normal" levels, the government might have to cover the shortfall. Likewise, volatility-induced consecutive negative returns might create an unanticipated demand for short-term government payments to enable the fund to meet obligations toward retired former employees - almost surely raising voices for pension fund reform in the process.

ANNUALIZED RATE OF RETURN OF MAJOR PUBLIC PENSION FUNDS

Pension Fund	FY 2003 Market Value	Investment Rate of Return FY 2003	FY 2002	3-year	5-year	10-year
California Public Employees	$144.8 billion	3.90%	3.70%	-3.30%	2.40%	8.20%
New York State Retirement System*	$111.2 billion	-10.20%	2.76%	-5.53%	1.56%	8.01%
California State Teachers	$100.5 billion	3.41%	-5.95%	-4.03%	2.46%	7.48%
Florida Retirement System	$90.4 billion	2.85%	-8.07%	-4.40%	1.94%	8.54%
Texas Teachers Retirement System**	$77.6 billion	4.70%	-6.40%	-2.40%	2.40%	8.60%
New York State Teachers	$72.4 billion	4.00%	-6.80%	-2.90%	2.20%	9.10%
New Jersey Division of Investment	**$62.3 billion**	**3.30%**	**-9.00%**	**-5.60%**	**1.80%**	**8.50%**
Wisconsin Investment Board***	$55.3 billion	4.60%	-4.80%	NA	3.10%	8.50%
Pennsylvania Public Teachers (PSERS)	$43.7 billion	2.74%	-5.25%	-3.39%	2.57%	NA
Oregon PERS	$37.0 billion	2.80%	-6.40%	-4.00%	**3.30%**	NA
Massachusetts PRIM	$27.9 billion	4.03%	-6.49%	-3.14%	3.52%	9.50%
Median Public Fund Return	**N/A**	**4.02%**	**-5.82%**	**-2.38%**	**2.71%**	**8.30%**

* FY ends March 31

** FY ends August 31

*** Fixed and Variable Trust Fund; numbers only consider FTF (VTF 10% of FTF)

The pension system's unusually pronounced variability of returns hinges on an atypical concentration of holdings in stocks and bonds that has exposed the system more to the mood swings of the stock and bond markets than funds with more diversified portfolios. Relative to the median, this over-reliance on traditional asset classes yielded superior gains in the late 1990s and greater losses over the last three years. Having shown what IFS considered to be a key contributing factor to the system's relative volatility, OLS will turn to the consultants' key remedy to assuage this variability: asset diversification.

ASSET DIVERSIFICATION TO REIN IN VOLATILITY

To strengthen the division's operations, IFS posited 79 suggestions that fall into six general categories: organizational structure and resources, ability to attract and retain employees, controls, investment policy statement, asset allocation, and investment management structure. OLS has been unable to ascertain the division's progress with respect to the implementation of the recommendations. The remainder of the background paper will focus on the most contested advice, namely to privatize the investment management of a portion of the

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system's portfolio.

IFS recommended asset diversification to render the system less volatile. To shrink total investment risk, it specifically counseled the division to invest in new asset classes such as real estate equity, venture capital, hedge funds, and high yield bonds. This suggestion is predicated on the belief that a reduction of an asset's share within a portfolio would decrease the portfolio's vulnerability to fluctuations in that asset's returns. According to that belief, a low correlation among the performances of distinct assets within a portfolio would narrow the annual variance in the portfolio's total returns and render the latter more predictable.

Whether a reduced reliance on traditional asset classes would actually produce higher aggregate yields in the long haul is unclear, as the answer depends on the relative returns of traditional and alternative asset classes over time. Indeed, some of IFS' recommended investments offer high returns, yet they do so because they carry more risk than conventional stocks and bonds. The performance of private equity, for example, is difficult to monitor. It is not publicly traded like stocks or bonds, so that it cannot be sold quickly; it has no listed price; and its performance cannot be tracked or evaluated in routine ways. In any event, if the system was to diversify its holdings to include asset classes deemed by some to be riskier than traditional stocks and bonds, its decision makers would have to resolve whether the alternative investments should be managed in-house or out-of-house.

ASSET DIVERSIFICATION AND PRIVATIZATION

According to IFS, since the division is presently lacking the in-house expertise to execute investments in the recommended new asset classes, it would likely have to seek that competency outside for an immediate implementation of the advice. IFS noted that the creation of internal investment teams would require time and the hiring of additional investment analysts. Because the consultants deemed the division's compensation schedule insufficiently competitive, they doubted that it could acquire the adequate level of talent without significantly boosting its pay scale. Instead, they proposed the hiring of external money managers to make nontraditional investment decisions. It is this proposed partial externalization of investment discretion that has generated publicly expressed concerns.

In a legal opinion, which has been made public by a legislator, the Office of Legislative Services (OLS) has laid out its view that the current statutory guidelines governing the division and the State Investment Council did not authorize the delegation of investment decisions to an external money manager. Nonetheless, citing a letter opinion from the Attorney General dated May 22, 1984, OLS has also noted that the division was presently not prohibited from utilizing external money managers on an advisory basis as long as the division itself would remain responsible for final investment decisions.

Independent of procedural requirements, critics have advanced reservations about the privatization of investment authority. They have suggested that the partial externalization of system operations would serve as a prelude to a more general divestiture. Mindful of the financial adequacy of the State employees' pension system, they have been voicing effectiveness and efficiency arguments against the contemplated privatization move.

Concerns have been voiced that no guarantee existed that external money managers would outperform division employees, especially as the former would charge the $62 billion system substantial fees that would inflate its current management cost of approximately $10

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million. The $44 billion Pennsylvania Public School Employees' Retirement System, for example, is paying more than $150 million per year to outside stock, bond, real estate, and private-equity management firms to administer roughly $28 billion of its portfolio. Thus, to justify their contracts, external managers must return more than the fees they charge plus the in-house returns that had accrued in the absence of privatization. Notwithstanding this fact, of the major public pension funds, only New Jersey has forgone the services of external managers entirely.

Critics have also pointed to money management contracts as an additional area in which "pay to play" issues may arise. Moreover, they have warned of a conflict of interest that might occur when pension fund consultants recommend money managers with whom they have business ties. Such concerns were recently addressed in a *New York Times* article, "Concerns Raised Over Consultants to Pension Funds" (March 21, 2004), that noted that the Securities and Exchange Commission had been scrutinizing the practices of two dozen pension consultants since December 2003 to learn how their pension work may conflict with their other business operations.

In December 2003, the State Investment Council voted to commit at least $4 billion to alternative investment classes, but the directive has not yet been executed. It is unclear if the pursuit of this asset diversification strategy is based on the exercise of investment discretion by the division directing those investments in-house in concurrence with the advice of outside money managers.

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Individuals wishing information and committee schedules on the FY 2005 budget are encouraged to contact:

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