Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 1 Agenda

Senator Marty Block, Chair
Senator Roderick D. Wright
Senator Mark Wyland

Thursday, April 25, 2013
9:30 a.m. or upon adjournment of session
Room 3191, State Capitol

Consultant: Kris Kuzmich

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SUMMARY CHARTS, ITEMS PROPOSED FOR VOTE ONLY

	Entity	**Description**	**Funding**	**Action**
1	California State Library	California Cultural and Historical Endowment Grant Funding	$1.395 million Prop 40 bond funds	Approve
2	California Community Colleges, Local Assistance	Economic and Workforce Development Program Expenditure Plan – Budget Bill Language (see Attachment 1)	BBL	Approve placeholder BBL

	Campus	**Description**	**Phase**	**Action**
	UC Capital Outlay: Continuing Project, Appropriation			
3	Merced	Science and Engineering Building 2	E	Approve
	CSU Capital Outlay: Continuing Projects, Appropriations			
4a	San Jose	Spartan Complex Renovation (Seismic)	E	Approve
4b	Maritime Academy	Physical Education Replacement	E	Approve
4c	Bakersfield	Art Center and Satellite Plant	E	Approve
4d	Fresno	Faculty Office/Laboratory Building	E	Approve
4e	Channel Islands	West Hall	E	Approve
4f	Bakersfield	Dore Theatre	P, WD, & C	Approve
	CCC Capital Outlay: Continuing Project, Appropriation			
5	Solano College, Solano City CCC District	Theater Modernization	P & WD	Approve

E=Equipment; P=Preliminary Plans; WD=Working drawings; C=Construction

Vote:

DESCRIPTIONS OF ITEMS PROPOSED FOR VOTE ONLY

ITEM 1. CSL CALIFORNIA CULTURAL AND HISTORICAL ENDOWMENT GRANT FUNDING

Governor's Budget Request. The January Budget requests an appropriation of $1.395 million (Proposition 40 bond funds) to fund additional cultural and historical resource preservation grants through the California Cultural and Historical Endowment (CCHE). The requested funds represent the unappropriated residual balance of the Proposition 40 sub fund for cultural and historical resource preservation.

Background. The CCHE was established at the California State Library in 2003 (Chapter 1126; Statutes of 2002) to raise the profile and scope of California's historic and cultural preservation program. CCHE is entirely Proposition 40 bond-funded, including both for state operations and the various grant programs it administers. Since its inception in 2003, CCHE has awarded over $122 million in preservation grants to help conserve the tangible aspects of California history.

The requested funds in the January Budget represent the balance of Proposition 40 dollars for cultural and historic resource preservation. Approximately $820,000 of the $1.395 million appropriation would be allocated to an existing wait list of unfunded Round Four Projects; the list consists of three projects in the cities of: (1) Atascadero (Restoration of City Hall - $270,000); (2) Avila Beach (Port San Luis Harbor District, Harford Pier and Warehouse Canopy Restoration - $300,000); and (3) San Francisco (Fort Mason Center, Pier 2 Restoration - $250,000). Using its existing statutory authority, CCHE would engage in a new Request for Proposal process to allocate the remaining $575,000 in grant funds.

CCHE is currently scheduled to formally close in 2015.

ITEM 2. CCC ECONOMIC AND WORKFORCE DEVELOPMENT PROGRAM EXPENDITURE PLAN – R BUDGET BILL LANGUAGE

Summary of Budget Issue. The January Budget proposes budget bill provisional language conditioning expenditure of $22.9 million in Economic and Workforce Development (EWD) program funds until the Chancellor's Office submits, by July 1, 2013, a proposed expenditure plan to DOF for approval. Subcommittee No. 1 heard this item on April 11, 2013, and held the item open, including expenditure of the $22.9 million in EWD funds, pending receipt of an expenditure plan. This action was taken to ensure legislative input into, and approval of, the expenditure plan. An expenditure plan has since been submitted; Attachment 1 to this agenda is the budget bill language that comprises the expenditure plan.

DESCRIPTIONS OF ITEMS PROPOSED FOR VOTE ONLY, Continued

ITEM 3. UC CAPITAL OUTLAY: CONTINUING PROJECT, APPROPRIATION

3. UC Merced Science and Engineering Building 2 - Equipment

Governor's Budget Request. In a Spring Finance Letter, the Governor requests that Item 6440-301-0658 be added in the amount of $375,000, and Item 6440-301-6048 be added in the amount of $3,845,000, to fund the equipment phase for the Merced Campus, Science and Engineering Building 2 project. The project provides instructional and research space for Merced's School of Engineering and Natural Sciences. The project is nearing completion (completion date of May 2014), and $4,220,000 for equipment is needed to ensure that the facility is fully operational when completed.

ITEM 4. CSU CAPITAL OUTLAY: CONTINUING PROJECTS, APPROPRIATIONS

4a. CSU San Jose Spartan Complex Renovation - Equipment

Governor's Budget Request. The January Budget requests $1.428 million for the equipment phase of the Spartan Complex Renovation Project. The project retrofitted the Spartan Complex, including the Uchida Hall/Natatorium, Uchida Hall Annex, Spartan Complex East, and Spartan Complex Central, which is classified with a seismic Level 5 rating. This project meets the current seismic, ADA, and life safety code requirements, as well as replacing the building systems.

4b. CSU Maritime Academy, Physical Education Replacement - Equipment

Governor's Budget Request. The January Budget requests $1.295 million for the equipment phase of the Physical Education Replacement Project. The new facility is 26,500 ASF/38,600 GSF and an outdoor pool to accommodate the physical education classes and the water activities required for licensure by the U.S. Coast Guard.

4c. CSU Bakersfield, Art Center and Satellite Plant - Equipment

Governor's Budget Request. The January Budget requests $533,000 for the equipment phase of the Art Center and Satellite Plant Project. The project resulted in a new art center and satellite mechanical plan, and extension of the campus sewer line.

4d. CSU Fresno, Faculty Office/Laboratory Building - Equipment

Governor's Budget Request. The January Budget requests $383,000 for the equipment phase of the Faculty Office/Laboratory Building Project. The project resulted in the construction a new, two-story facility to house graduate research laboratories, classroom space, and faculty offices for the Colleges of Health and Human Services and Physical Education.

4e. CSU Channel Islands, West Hall – Equipment

4f. CSU Seismic Upgrade Dore Theatre - Preliminary plans, Working Drawings and Construction

Governor's Budget Request. The January Budget contains proposed reversions of $4,190,000 in state General Obligation (GO) bonds that were appropriated in the Budget Act of 2012 as a state match for five life-safety projects at CSU campuses. These projects were proposed to be funded with a combination of GO bonds and federal reimbursements. However, the federal reimbursements did not materialize. In a Spring Finance Letter, the Governor requests that $4,042,000 (of the $4,190,000 in reverting GO bonds) be appropriated for the equipment phase of a continuing capital project so that it can be fully operational when completed, and the design and construction for a new capital project that provides seismic strengthening for an existing campus theatre, as follows:

CSU Channel Islands, West Hall - Equipment. Add Item 6610-301-6048 in the amount of $2,258,000 from the 2006 University Capital Outlay Bond Fund to fund the equipment phase for the West Hall project. The project will provide new space for lecture, laboratory and faculty offices to support various campus programs such as computer science, environmental science, and physics. The Project will be completed by February 2015, but equipment needs to be ordered before the 2014-15 fiscal year to allow sufficient time for procurement and installation of "long lead" time scientific equipment and information technology/telecommunications equipment.

Bakersfield, Seismic Upgrade Dore Theatre - Preliminary Plans, Working Drawings, and Construction. Add Item 6610-301-6048 in the amount of $1,784,000 from the 2006 University Capital Outlay Bond Fund to fund the design and construction phase of the Seismic Upgrade Dore Theatre project. This project will provide strengthening work, such as roof bracing and connections, to support columns and walls of the 32-year old Dore Theatre. The CSU's Seismic Review Board identified this project as a high priority and the Division of State Architect has rated this building as a seismic level six (out of seven), meaning that in a seismic event, the building would incur substantial structural damage with partial collapse likely, with extensive risk to life for the occupants.

DESCRIPTIONS OF ITEMS PROPOSED FOR VOTE ONLY, Continued

ITEM 5. CCC CAPITAL OUTLAY: NEW PROJECT, APPROPRIATION

5. Solano City CCC District, Solano College, Theater Modernization – Preliminary Plans and Working Drawings

Governor's Budget Request. The January Budget requests $1.183 million for preliminary plans and working drawings for a project to modernize the Solano College Theater. The project will renovate, for health and safety reasons, the 20,093 ASF/25,231 GSF building that houses the Music and Theater Arts Programs. The renovation will address severe safety and health, seismic, ADA accessibility, and failing building infrastructure issues that make the existing building nearly uninhabitable. Due to the nature and severity of the issues, an extensive renovation is the only realistic means to address these problems.

The CCC Chancellor's Office estimates that the construction phase of this project would cost $12.5 million, for a total project cost of $13.7 million. The Chancellor's Office has also indicated that the system has enough GO bond funds to complete the construction phase of the project (scheduled to be completed in July 2016).

Item 6: LAO Overview of Infrastructure Planning, Budgeting, and Financing

Panelist: Legislative Analyst's Office

Summary of Agenda Item. In this informational item, the LAO will provide the subcommittee with a brief overview of how the state plans, budgets, and finances infrastructure projects.

The LAO will also discuss how the universities finance non-state infrastructure projects.

This item is intended to provide background information to help the subcommittee understand the current infrastructure budget process for the universities, given that the Governor is proposing to significantly change this process (discussed as Agenda Items 6 and 7).

Staff Recommendation. None; this is an informational item.

Item 7: UC, CSU, and Hastings - Combine Capital and Support Budgets and Change Project Approval Process

Governor's Budget Request. The January budget proposes a different approach to capital outlay for UC, CSU, and Hastings, as follows:

- ✓ *Combine Capital and Support Budgets.* Shifts a total of about $400 million in debt service costs for general obligation (GO) bond-financed capital improvements at UC ($201 million), CSU ($198 million), and Hastings ($1.2 million) into each segment's base budget; makes one last adjustment to UC and CSU budgets for lease-revenue (LR) bond debt service costs and then shifts the total LR debt service funding level of $221 million and $90.5 million, respectively, into each segment's base budget; and proposes no further augmentations or adjustments for either form of debt service payment going forward. Hastings does not currently have any state-issued LR bond debt.

- ✓ *Annual Funding Increases.* Under the Governor's multi-year plan for higher education, UC and CSU are slated to receive roughly five percent increases each year in the first two years of the plan, and then four percent increases each year in the final two years of the plan. Hastings would receive similar annual increases over the life of the plan. These percentage increases would apply to the *combined* capital and support budgets.

- ✓ *Limits on the Use of Combined Budget for Purposes of Capital Outlay.* Proposes budget trailer bill language limiting use of the combined capital-support appropriation to fund pay-as-you go capital outlay projects. The limits are based on the current percent of debt service to the GF support appropriation; those percentages are 15, 12, and 17, for UC, CSU, and Hastings, respectively. Similar percentage limits are also placed on new authority for the segments to pledge their GF appropriation to: (a) issue their own debt for capital projects; and (b) restructure their respective LR bond debt related to their projects (this latter issue is discussed in the next item in this agenda).

- ✓ *Changes to Project Approval Process.* Proposes budget trailer bill language making any new capital expenditures subject to review and approval by the DOF and the Joint Legislative Budget Committee (JLBC), separate from the annual budget process. Projects using state funds would be limited to academic facilities needed for safety, enrollment growth, or modernization purposes, as well as infrastructure projects that support academic programs.

Background. Under current law, the Administration is required to identify statewide infrastructure needs and develop proposals for their funding. Chapter 606 (1999) directs the Governor to annually submit a statewide five-year infrastructure plan and a proposal for its funding. The statewide plan is a consolidation of individual five-year plans developed by state agencies. No Administration has provided a statewide five-year infrastructure plan since the Governor's 2008-09 budget proposal.

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This Administration indicates that it intends to release a five-year infrastructure plan this spring, which would outline the Administration's infrastructure priorities for the next five years. Additionally, the *Budget Summary* suggests that the Administration is considering some changes to the state's infrastructure spending practices, including identifying alternatives to limit future bond authorizations backed by the GF, currently the state's main source of infrastructure funding. Some alternatives mentioned include identifying new funding sources and creating new mechanisms to prioritize and limit capital spending.

Historically, the state has provided infrastructure funding for the segments' core academic missions. For CSU and Hastings, this core funding is limited primarily to instructional and administrative space, while the state supports those functions, as well as research space, at UC.

In the last ten years, the LAO reports that the state has spent an estimated $10.1 billion on higher education infrastructure for UC, CSU, and the California Community Colleges. Eighty percent of that support came from GO bonds and an additional 19 percent from LR bonds. Associated higher education debt-service costs more than doubled during this same time period, from about $516 million in 2000-01 to an estimated $1.1 billion in 2010-11. Most of the GO bond spending was from bonds approved by the voters in 1998, 2002, 2004, and 2006. In general, the state provides less funding for higher education projects when the balance of GO bonds is exhausted. In the case of UC and CSU, the state has typically offset some of this reduction by funding some projects with LR bonds. The Legislature has direct control over state-funded projects, whether from GO or LR bonds, because each project is funded through an appropriation in the annual budget act.

Currently, the remaining higher education GO bond authority for UC and CSU is nearly exhausted; Hastings' authority is completed exhausted. As contained in the "vote-only" section in this agenda, the remaining GO bond funds for UC and CSU are being allocated primarily to the final equipment phases of existing projects. Any new GO bond proposal would have to be placed on the ballot and approved by the voters. AB 41 and SB 301, which are currently pending action before policy committees, both propose a Kindergarten-University Public Education Facilities Bond Act of 2014 and authorize an unspecified sum of state general obligation bonds for education facilities.

The spring and fall 2013 LR bond sales will include previously approved and appropriated LR bond-funded projects for UC and CSU, effectively funding the last projects in the LR bond pipeline. There are no other LR bond-funded projects in the pipeline, as this Administration has not advanced any new LR bond-funded projects for either UC or CSU.

The segments have identified significant unmet capital outlay needs both in the long-term and for 2013-14. For 2013-14, both the UC and CSU governing boards adopted extensive state-funded capital outlay programs, with 39 projects totaling $788.5 million and 38 projects totaling $520

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million, respectively. The 2013-14 budget request submitted to the Administration was much smaller: UC advanced four projects totaling $75.2 million and CSU advanced 21 projects totaling $390.3 million. Hastings has identified long-term needs of $24 million, of which $22 million is designated as high priority. The highest priorities for each are displayed in Figure 1 below:

Figure 1: Highest Priority 2013-14 Capital Outlay Requests by Segment

Campus	Project	Phase	Amount
UC Merced	Classroom and Academic Office Building	C	$45,144,000
UC Riverside	Batchelor Hall Building Systems Renewal	WD & C	$13,788,000
UC Santa Barbara	Infrastructure Renewal Phase 1	C	$11,990,000
CSU Statewide	Infrastructure Improvements	P, WD, & C	$22,800,000
CSU Pomona	Administration Replacement Facility (Seismic)	P, WD, & C	$76,546,000
Hastings	100 McAllister Tower Classroom Expansion	P, WD, & C	$12,700,000

P=preliminary plans; WD=working drawings; C=construction

Both UC and CSU also have extensive deferred maintenance needs; UC reports $1.1 billion in need, of which $426 million is designated high priority, and CSU reports $1.7 billion in need, of which $462.9 million is designated high priority.

LAO Recommendation. The Administration indicates the motivation for combining the universities' support and capital budgets is to provide the universities with increased flexibility, given limited state funding. However, the Administration has not identified specific problems associated with the current process used to budget the segments' capital projects, nor identified any specific benefits the state might obtain from the proposal. As a result, both the problem the proposal is intended to address, and the benefit that the proposal offers, are difficult to ascertain.

Given the lack of a compelling policy rationale for the proposal, along with the serious concerns regarding the loss of the Legislature's ability to plan and oversee infrastructure projects, the Legislature should reject the Governor's proposal. If the Legislature is interested in developing a new process for funding the segments' capital projects, then it would need to grapple with several fundamental issues. Most importantly, the Legislature would need to: (1) identify the specific problems with the current capital outlay process; and (2) develop a new method for allocating and overseeing funding that addresses these problems. As part of this process, if the Legislature did decide to combine capital and operational funding, then the Legislature would need to assess annual ongoing capital priorities, identify a reasonable initial amount to transfer, decide how to adjust that amount moving forward, and decide whether the segments should be able to pledge their state appropriations to issue debt. Without addressing such fundamental issues, moving to a new process as proposed by the Governor is premature.

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Staff Comment. The Governor's approach is a dramatic departure from how UC and CSU (as well as Hastings) capital outlay has been historically addressed. This change is being proposed without any analysis of ongoing needs, not only for capital outlay, but also for deferred maintenance, for building stock constructed primarily in the 1940s, 1950s, and 1960s at existing campuses, and for campuses that might be needed in the future, such as in Chula Vista or the Antelope Valley. Rather, the budget proposal simply presumes the amount of debt service funding related to one fiscal year (2013–14) is an appropriate amount upon which to base ongoing needs, yet offers no evidence to this effect.

To this point, a "point-in-time" approach does not address potential inequities in current debt service funding levels between UC and CSU. Under the Administration's proposal, CSU would have $90.5 million in existing LR bond debt service shifted into its GF appropriation, while UC would have $221 million for the same purpose shifted into its base budget. Although, CSU has twice as many campuses and students as compared to UC, under the Administration's proposal, both UC and CSU are treated the same going forward.

For Hastings, this proposal does not work, due in large part to the relative size of its budget. Hastings' GF appropriation of $9.5 million (includes shift of $1.2 million to support GO debt service) accounts for about 16 percent of its core operating costs, and tuition fee revenue provides about 84 percent. By comparison, for UC and CSU, GF and tuition fee revenue account for close to 50 percent each of core operating costs. Therefore, shifting $1.2 million in GO debt service costs into Hastings' base budget and growing it by the 5-5-4-4 plan, and expecting Hastings to keep tuition fees constant (another component of the Governor's multi-year plan for higher education), results in an inability to address all operating needs, let alone capital needs. The Administration testified at the March 14 hearing that it would consider larger percentage increases (than the 5-4-4-4) in the 2014-15 fiscal year and the following two years to address this concern; the Administration proposes no changes to the 2013-14 budget proposal as it pertains to Hastings.

If the Administration is concerned about overall debt capacity and priorities for state infrastructure spending, and where higher education fits into those priorities, that conversation begins with the five-year infrastructure plan. However, this budget proposal effectively presupposes the outcome of that conversation, as the Administration has decided that higher education can go it alone (albeit with annual increases in base funding for the next four fiscal years). In the absence of a larger conversation about statewide infrastructure needs, or an analysis that shows the provided funding in 2013-14 is the level needed to meet the segments' infrastructure needs today, tomorrow, and into the future, staff finds no justification to change higher education capital outlay practices as proposed by the Governor.

Removing these decisions from the annual budget process is also troubling as it would effectively cede the Legislature's authority to make high level decisions about annual expenditures on higher education, be they for support or capital outlay. Shifting control over

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spending priorities away from the Legislature raises serious questions given that the universities are statewide, public institutions.

In considering these issues, the subcommittee must also acknowledge that if it rejects the Governor's proposals, what is the process or means by which the capital needs of UC, CSU, and Hastings will be addressed?

Staff Recommendation. Reject the proposals to combine the segments' capital and support budgets and to change the capital outlay project approval process, including the proposed budget trailer bill language and the conforming changes made to various budget bill items and provisions related to capital outlay. Request that the Administration return with the five-year infrastructure plan, including a proposal to address UC, CSU, and Hastings capital outlay needs, at May Revision.

Vote:

Item 8: UC and CSU - Lease-Revenue Bond Debt Restructuring Proposal

Governor's Budget Request. The January Budget proposes budget trailer bill language to authorize UC and CSU to pledge their GF appropriation to restructure their respective state Public Works Board-issued lease-revenue (LR) bond debt. Under the proposed language, the pledged amount is limited to 15 and 12 percent of the total GF appropriation, respectively, which is the current percent of debt service cost to GF support appropriation for UC and CSU.

The trailer bill language was modified by a Spring Finance Letter to state that DOF approves UC using this new authority to restructure its LR bonds to generate savings sufficient to fund the $45.144 million construction phase of the UC Merced Classroom and Academic Office Building project from its support budget.

The Administration indicates it is proposing the trailer bill language to provide the segments with the authority to refinance debt at better rates and produce budgetary savings.

Background. Debt refunding (or refinancing) allow for issuance of new bonds at a lower interest rate but for the same (or shorter) term in order to realize cash-flow savings, similar to refinancing a home mortgage. The state routinely refinances its debt to take advantage of lower interest rates. In these transactions, the state keeps the same repayment schedule, or shortens it, reducing its interest costs.

Debt restructuring transactions allow for issuance of new bonds with a different debt schedule. Debt restructuring can result in cash flow savings, but also typically means paying more in interest costs. The state does not restructure its debt to longer repayment periods for this reason.

The Public Works Board (PWB) was created by the Legislature to, among other functions, oversee the fiscal matters associated with construction of projects for state agencies. The PWB is also the issuer of LR bonds. The Legislature appropriates funds for capital outlay projects; through review and approval processes, the PWB ensures that capital outlay projects adhere to the Legislature's appropriation intent.

The state currently has about $2.5 billion in outstanding PWB-issued LR bond debt for projects built at UC. For CSU, the state currently has about $1 billion in outstanding PWB-issued LR bond debt. In 2013–14, the state will spend about $221 million and $90.5 million, respectively, to service this debt. Under the budget proposal, UC and CSU would be granted the authority to repay the state's bondholders the $2.5 billion and $1 billion, respectively, owed to them by issuing their own bonds on their own terms.

In response to the Governor's proposal to allow the universities to restructure state infrastructure-related debt, UC has developed two potential restructuring scenarios. (The CSU has not yet presented a proposal.) Under both scenarios, UC would restructure the existing LR debt over a 40-year period. Under the state's current repayment schedule, this debt would be retired fully in half that time. Under UC's first scenario, the restructured debt is entirely fixed rate; under the second, the restructured debt is 70 percent fixed rate, and 30 percent

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variable rate. Because UC would extend the repayment period so far into the future, UC estimates it could lower the annual debt service payment by about $80 million a year for ten years under both scenarios. Additional savings under the second scenario include $30 million a year for the next nine years. Under both scenarios, after year 10 and year 19, respectively, the university would begin paying a few million dollars more in debt service annually than under the current repayment schedule. This difference would increase significantly in later years, such that under the first scenario, over the life of the restructured debt, UC estimates it would pay an additional $2.1 billion. In today's dollars, this means the restructuring would cost nearly $400 million. Under the second scenario, the additional cost in today's dollars is $4.3 million.

LAO Analysis. UC asserts that extending the repayment term to 40 years matches the life span of the buildings built with the bonds. By pushing debt out to years in which there otherwise would be no debt service, this approach, however, risks making investments in future facilities more difficult. For example, the university may have difficulty undertaking as many new capital projects 30 years from now, as it otherwise could, because it still would be paying off debt issued over 30 years earlier. Faced with such a situation, UC likely would have to: (1) forgo capital projects it otherwise would have undertaken; (2) redirect funding that otherwise would have gone to support instruction or research; (3) seek additional funding from the state; and/or (4) increase student tuition.

The examples above reflect two scenarios provided by UC as to how it could restructure the state's LR debt. The universities could develop other proposals with different repayment periods and financial assumptions. These other proposals potentially could have lower costs. By definition, however, restructuring typically means extending out debt repayments into the future. As a result, debt restructuring typically means paying more in interest. For this reason, the state does not restructure its debt to longer repayment periods.

LAO Recommendation. Given that restructuring debt would cost more money in the long term and constrain future budget choices, the Legislature should reject the Governor's debt restructuring proposal for the universities. If the Legislature is concerned that the universities would lose the short-term savings associated with the debt restructuring, it could consider other strategies for the universities to increase revenue or reduce costs.

Staff Comment. Debt restructuring is inherently a form of budgetary borrowing, as it effectively removes the connection between the financing and usable life of the asset. It may well free up cash in the short term, but in the longer term debt restructuring requires payment of more interest. For these reasons, this proposal is inconsistent with this Administration's overall message to pay today for today's costs, and not defer or delay those costs into the future and pay more for them.

The stated reasons for this proposal include that it will help the state's financial picture by removing the PWB-issued debt from the state's balance sheet. However, because the universities' ability to refinance the debt is predicated on their being able to pledge their GF appropriation, *funding that is subject to an appropriation in the annual budget act*, it is not clear

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how responsibility for this debt would actually be removed from the state's balance sheet. UC has also not confirmed that this shift would not have a material impact on the University's credit ratings or future borrowing capacity.

This proposal also suffers from inadequate analysis or assurance as to the out-year impacts. UC indicates that the rating agencies cannot offer a clear judgment on exactly how they will view this transaction until the final budget language is adopted. Staff respectfully disagrees. The Administration has released budget trailer bill language, drafted by Legislative Counsel, to effectuate this proposal. It would seem this is concrete enough to allow the Administration and UC to obtain verification as to the market impacts of the proposal, prior to asking the Legislature to act on it. Staff is also concerned by the two debt restructuring scenarios presented by UC. The first scenario, which is 100 percent fixed rate, is quite costly. The second scenario, where the debt is 70 percent fixed rate and 30 percent variable rate, is less costly but exponentially more risky as UC would be subject to risk assumptions about variable rate debt. It is also questionable to propose variable rate debt when rates are so low; i.e., rates likely will only go up.

Staff Recommendation. Reject the budget trailer bill language.

Vote:

Item 9:	**LAO Overview of Recent Changes to the Cal Grant Program**

Panelists: **Legislative Analyst's Office**
Department of Finance
California Student Aid Commission

Summary of Budget Issue. The Budget Acts of 2011 and 2012 made significant statutory changes to the Cal Grant program, particularly with regard to eligibility criteria for participating institutions where more than 40 percent of undergraduate students borrow federal student loans, to address concerns about participating institution quality and in order to reduce overall program costs. None of these changes impacted the entitlement aspect of the Cal Grant program. The LAO will present an informational item to the subcommittee as to these statutory changes, which are summarized in Figure 2 below. The LAO will also present to the Subcommittee its findings and recommendations from its recent analysis of these program changes.

Figure 2: Summary of Recent Changes to the Cal Grant Program

Program Change	2013-14 Law	*Prior Law*
Tighter Eligibility Criteria for Participating Institutions	Participating institutions must maintain a maximum cohort default rate (CDR, proportion of former students defaulting on federal student loans) of 15.5 percent and a minimum graduation rate of 30 percent.	*No policy prior to 2011-12, when a CDR of 24.6 percent was instituted.*
Reduction in Award Levels for Non-Public Institutions	Cal Grant A and B new maximum awards will be $9,084 at independent non-profit institutions and WASC-accredited private for-profit institutions, and $4,000 at all other private for-profit institutions.	*Prior to 2012-13, the maximum award levels had been $9,708 for all non-public institutions since 2000 (except for 2004-2006, in which it was reduced to $8,322). In 2012-13, Governor's veto reduced award levels by five percent, to $9,223.*
Renewal Awards at Ineligible Institutions	Cal Grant eligible students attending an ineligible institution will not be able to renew their Cal Grant for the 2013-14 academic year if they choose to remain at that ineligible institution.	*No policy prior to 2011-12, when renewal awards were reduced by 20 percent if a student chose to remain at an ineligible institution.*
Tighter Eligibility Criteria for Renewal Recipients	Cal Grant recipients applying for renewal awards must meet certain financial eligibility criteria.	*Prior to 2011-12, Cal Grant recipients had to demonstrate financial need but not meet these "certain" criteria upon renewal.*

Item 9:	*LAO Overview of Recent Changes to the Cal Grant Program, continued*

Figure 2: Summary of Recent Changes to the Cal Grant Program, Continued

Program Change	2013-14 Law	*Prior Law*
Awards Levels Reduced Through Governor's Veto Action	Through a veto action, the Governor reduced certain Cal Grant awards by five percent ongoing: (1) Cal Grant B access award – $1,473; (2) Cal Grant C tuition and fee award – $2,462; and (3) Cal Grant C book and supply award – $547.	*Prior to 2012-13, Cal Grant B access award had been $1,551; the Cal Grant C tuition award had been $2,592; and the Cal Grant C book and supply award had been $576.*
Community College Transfer	Codified CSAC practice limiting community college transfer entitlement awards to students who attended a CCC in the academic year before transferring to a four-year institution.	*N/A*

LAO's Analysis of the New Eligibility Rules. The recent budget act changes included a requirement that the LAO monitor initial implementation of the changes and analyze the state's other options for measuring institutional quality. In its report issued January 7, 2013, the LAO found that the changes, which primarily affect students at for-profit schools, are generally working as intended but have three notable drawbacks: (1) schools can manipulate the CDR; (2) the rules exempt some institutions without strong justification for doing so; and (3) the standards penalize institutions serving more disadvantaged students.

The LAO recommended exploring alternative student debt measures when the information needed to calculate these measures becomes more readily available and applying the graduation rate requirement to all schools but modifying the measure to track the graduation rate only of Cal Grant recipients. In addition, the LAO recommended taking into consideration a school's student characteristics to avoid creating a disincentive to serve disadvantaged students.

The LAO also raised concerns about the actual implementation of the new standards and made recommendations to address those concerns. More specifically, although CSAC is required by statute to certify institutional eligibility by October 1 each year, the U.S. Department of Education plans to release new graduation rate data later in October. For this reason, the LAO recommended changing the certification deadline to November 1, if the Legislature maintains the current graduation rate measure, as well as clarify that CSAC should use the most recent publicly available data in any form for its certification (discussed further as Agenda Item 9).

The LAO also noted that the recent policy changes, implemented in the middle of Cal Grant award cycles, have left many students with insufficient time to make alternative plans for the coming academic year. Moving forward, the LAO recommended the Legislature avoid making changes to eligibility rules during award cycles already underway, instead making them effective for the next award cycle. Some eligibility changes, such as those requiring consultation on specific metrics to be used, may require even longer implementation lags.

Staff Recommendation. None; this is an informational item.

Item 10: Cal Grant Program Statutory Clean-up

Summary of Budget Issue. The Budget Acts of 2011 and 2012 made significant statutory changes to the Cal Grant program. These changes were primarily focused on refining institutional eligibility based on graduation rates and cohort default rates (CDR) as a measure of quality [Education Code (EC) Section 69432.7 – Attachment 2]. Since the adoption of these statutory changes, three issues have arisen about legislative intent and/or implementation of several subparagraphs of EC 69432.7, as highlighted below.

ISSUE 1. Under current law, the Student Aid Commission (CSAC) is required to certify, by October 1 of each year, the institution's latest three-year CDR and graduation rate, as most recently reported by the United States Department of Education. [EC 69432.7 (l)(3)(A)]

In its January 2013 report, the LAO recommended changing the certification date From October 1 to November 1 to facilitate CSAC's data collection. The November 1 date better reflects the U.S. Department of Education's (Department) schedule for posting graduation rates to IPEDS, the Integrated Postsecondary Education Data System. Additionally, the LAO recommended that the Legislature clarify that CSAC should use the most recent publicly available data, published by the Department in any form, for its annual certification. Since the publication of the LAO recommendation, additional developments potentially point to a need to clarify this statute further.

On March 1, 2013, the San Francisco Superior Court officially noticed that it ordered injunctive relief to the Academy of Art University making the Academy eligible for the Cal Grant program in 2012-13 and 2013-14 based on the information available on the College Navigator website in July 2012. Given this action, the subcommittee may wish to consider providing greater specificity in statute as to what graduation rate data (preliminary versus provisional), published by what date, to what site, etc., to avoid further confusion and ensure consistent program administration.

CSAC will be considering the Superior Court ruling at its April 25-26 meeting; it is possible the Commission will make the decision to appeal the ruling. Therefore, the subcommittee should delay any immediate action on this issue.

Staff Recommendation. Hold this issue open pending receipt of additional information from the Administration.

ISSUE 2. As CSAC continues to implement the new Cal Grant institutional eligibility policy, the LAO has raised a concern that the borrower data CSAC used for 2013-14 eligibility is not what EC 69432.7 (l)(3)(H) directs them to use.

Under current law, institutions with 40 percent or fewer undergraduates borrowing federal loans

Item 10: Cal Grant Program Statutory Clean-up, continued

are exempt from the default and graduation rate requirements with statute specifying which borrower data to use:

> EC 69432.7(l)(2)(H) Notwithstanding any other law, the requirements of this paragraph shall not apply to institutions with 40 percent or less of undergraduate students borrowing federal student loans, using information reported to the United States Department of Education for the academic year two years before the year in which the commission is certifying the three-year cohort default rate or graduation rate pursuant to subparagraph (A).

To determine 2013-14 eligibility, CSAC certified the CDR and graduation rates for Cal Grant institutions in fall 2012. However, instead of using 2010-11 data as required, CSAC used 2009-10 data.

The LAO reports that the purpose of the borrowing rate is to identify institutions with a relatively high share of students with loans. Using the most recently available data is good policy, as it provides the most recent snapshot of which institutions have a high share of borrowers. The LAO indicates that an administrative fix should suffice; i.e., because the statute is clear, no legislative action is required. This issue can be resolved by CSAC changing its eligibility determination for 2013-14.

At the time of the writing of this agenda, CSAC had not provided a response to staff's inquiry about whether it would address this issue administratively, as proposed by the LAO.

Staff Recommendation. Hold this issue open pending receipt of additional information from the Administration.

ISSUE 3. Subparagraph (l)(3)(I) of EC 69432.7 was adopted to provide a transition period of five years for an institution with a CDR of less than ten percent and a graduation rate of more than 20 percent (but less than 30 percent), for students taking 150 percent or less of the expected time to complete degree requirements, to remain eligible for initial and renewal Cal Grant awards through the 2016-17 academic year. In 2017-18, that institution would have to have a minimum graduation rate of 30 percent to remain eligible for the Cal Grant program.

As previously noted, in adopting this subparagraph the Legislature intended to provide this "grace" period if the institution *maintained* a CDR of less than ten percent. However, a drafting error resulted in this intent not being clear. CSAC has interpreted statute to mean an institution that meets the requirement *at any time*, gets a pass through to 2016-17 whether or not the institution's CDR remains within the exception window during that time.

Staff Recommendation. Hold this issue open pending receipt of further input from the Administration.

Item 11: Fund Offsets – Temporary Assistance for Needy Families (TANF) and Student Loan Operating Fund (SLOF)

Governor's Budget Proposal. The January Budget proposes two fund offsets, with no programmatic effect on financial aid programs, as follows:

1. Offset $942.9 million in Cal Grant Program GF costs to reflect increased Temporary Assistance to Needy Families (TANF) Program funds available through an interagency agreement with the Department of Social Services. *This is an increase of $139.2 million over the level of offset included in the Budget Act of 2012.*

2. Offset $60 million in Cal Grant Program GF costs due to the availability of surplus funds from the Student Loan Operating Fund (SLOF), which receives proceeds from the federal guaranteed student loan program. *The Budget Act of 2012 included an offset of $84.7 million GF from this same fund source.*

Background. Historically speaking, the Cal Grant program has been funded primarily with GF support. In recent fiscal years, the Administration has proposed fund transfers, with no programmatic effect on financial aid programs. The SLOF offset has been used for a number of years; the Budget Act of 2012 included a TANF offset for the first time. The Governor's January Budget again proposes this approach, utilizing both offsets.

With regard to the TANF funds, the Administration indicates that this shift is an allowable use of TANF funds because support for low-income, unmarried students age 25 or younger could prevent and reduce out-of-wedlock pregnancies, which is one purpose of TANF. The CalWORKs program budget is within the jurisdiction of Subcommittee No. 3.

With regard to the SLOF transfer, the SLOF receives proceeds from the federal guaranteed student loan program. In 2010, the federal government transferred management of this program from CSAC to ECMC, a national loan servicing organization. ECMC has agreed to contribute SLOF support to offset Cal Grant costs for several years. The number and amount of transfers are unspecified and is typically determined by ECMC in May of each year, in consultation with the federal Department of Education. The state budget is adjusted accordingly during the May Revision process.

LAO Recommendation. The Legislature should conform TANF funding for Cal Grants to decisions on CalWORKs. The Legislature should also increase SLOF funding for Cal Grants by $25 million over the Governor's proposed amount for the budget year and reduce General Fund support by the same amount.

Staff Comment. Both of these fund transfers have no programmatic impact on the Cal Grant program.

With regard to the TANF shift, any action by this subcommittee should conform to the action(s) of Subcommittee No. 3, especially given that it has raised concerns about the proposed level of

Item 11:	*Fund Offsets – Temporary Assistance for Needy Families and Student Loan Operating Fund, continued*

the funding swap between TANF and GF resources used for Cal Grants. More specifically, Subcommittee No. 3 is concerned that the swap reduces transparency in budgeting for the core purposes of the programs and results in an artificially higher reliance of CalWORKs on GF expenditures. This significantly higher reliance on the GF is especially problematic for CalWORKs because it is a program that is intended to provide a safety net during times of economic contraction and, as such, may experience necessary growth precisely when GF resources are scarcer.

With regard to the SLOF offset, the final figure of available funds will not be known until shortly after the release of the May Revision. Therefore, the subcommittee may wish to hold this aspect of the offset proposals open, pending ECMC Board action and receipt of updated information from the Administration.

Staff Recommendation. (1) Conform to the action(s) of Subcommittee No. 3 regarding the CalWORKs program and available TANF funds and (2) hold open the SLOF offset, pending receipt of updated information from the Administration at the time of May Revision.

Vote:

Item 12: Federal Sequestration – Financial Aid Program Impacts

Background. The federal sequester is an automatic, across-the-board, spending reduction on many federal programs, intended to ensure a $1.2 trillion deficit reduction over 10 years. Generally speaking, the reductions are half from defense and half from non-defense programs. The first set of reductions took effect March 1, 2013, impacting mostly federal discretionary spending ($71 billion in cuts) and some mandatory programs ($14 billion in cuts). Certain programs were exempted from the sequester, including entitlements and Pell grants for college students, among others.

Due to the sequester, all federally-funded education programs (other than Pell grants) are subject to an automatic across-the-board reduction of roughly 5.3 percent. Students will also see an increase in the origination fee charged for new federal student loans taken after July 1, 2013. Additional reductions to education programs (including Pell grants) will likely occur in Fiscal Years 2014 through 2021 due to stringent "caps" on so-called discretionary-funded programs, which include all education programs (other than student loans).

Staff Comment. The full impacts of the March 1 reductions are not yet known.

The Student Aid Commission reports that the federal College Access Challenge Grant Program (CACGP) is impacted by the sequester. The CACGP is intended to foster partnerships among federal, state, and local governments and philanthropic organizations through matching challenge grants that are aimed at increasing the number of low-income students who are prepared to enter and succeed in postsecondary education.

The CACGP was authorized for a five-year period, through the 2014-15 fiscal year. California receives approximately $14 million, and it is expected that funding will be reduced by an automatic across-the-board reduction of roughly five percent. The Commission will report at the hearing on the impact(s) of this reduction in funding, as well as information on other impacts of the federal sequester.

Staff Recommendation. This is an informational item.

Attachment 1: California Community College Economic and Workforce Development Program Expenditure Plan – Budget Bill Language

28. Of the funds provided in Schedule (17) for the Economic and Workforce Development Program (EWD), which are pursuant to Part 52.2 (commencing with Section 88600) of Division 7 of Title 3 of the Education Code,
(a) Up to eleven percent may be allocated for state level technical assistance activities in support of the intent of Chapter 361, Statutes of 2012, including statewide network leadership, organizational development, coordination, information and support services, or other program purposes.
(i) Any augmentation to state level activities funding is subject to approval of the Department of Finance, not sooner than 30 days after the notification in writing to the chairpersons of the fiscal committees of each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee.
(b) All remaining funds shall be allocated for programming that target investment at priority and emergent sectors, including statewide and/or regional centers, hubs, collaborative communities, advisory bodies, and short-term grants. Short-term grants can include industry-driven regional education and training, Responsive Incumbent Worker Training, and Job Development Incentive Training.
(c) Prior to the expenditure of these funds, the Chancellor of the California Community Colleges shall submit a proposed expenditure plan and the rationale therefore, to the Department of Finance for approval. The expenditure plan shall include the following:
(i) A statewide and regional delivery system.
(ii) A targeting of investments to competitive and emergent sectors important to regional economies as well as use of short-term grants to meet employer-driven training needs.
(iii) Program support to increase the impact of college CTE programs (including contextualized CTE programs) on regional economies; statewide accountability data collection and performance evaluation; statewide training, development, and coordination; labor market research; and continuous program improvements.
(d) The following provisions apply to the expenditures of these funds:
(i) Funds applied to performance-based training shall be matched by a minimum of $1 of private business and industry funding for each $1 of state funds. The board of governors shall consider the level of involvement and financial commitments of business and industry in making awards for performance-based training.
(ii) Funds allocated by the Board of Governors of the California Community Colleges under this program may not be used by community college districts to supplant existing contract education offerings. The chancellor shall ensure that funds are spent only for expanded services and shall implement accountability reporting for districts receiving these funds to ensure that training, credit, and noncredit programs remain relevant to business needs.
(iii) Any funds that become available due to savings, discontinuance, or reduction of amounts shall be evaluated against labor market needs and regional economies for reallocation within the economic and workforce development program.
(e) Fiscal agents of program funds intended to serve statewide or regional functions do not have authority to flex program funds. The chancellor's office may adjust allocations, as necessary, to preclude this action.

Attachment 2: Education Code Section 69432.7

69432.7. As used in this chapter, the following terms have the following meanings:

(a) An "academic year" is July 1 to June 30, inclusive. The starting date of a session shall determine the academic year in which it is included.

(b) "Access costs" means living expenses and expenses for transportation, supplies, and books.

(c) "Award year" means one academic year, or the equivalent, of attendance at a qualifying institution.

(d) "College grade point average" and "community college grade point average" mean a grade point average calculated on the basis of all college work completed, except for nontransferable units and courses not counted in the computation for admission to a California public institution of higher education that grants a baccalaureate degree.

(e) "Commission" means the Student Aid Commission.

(f) "Enrollment status" means part- or full-time status.

(1) "Part time," for purposes of Cal Grant eligibility, means 6 to 11 semester units, inclusive, or the equivalent.

(2) "Full time," for purposes of Cal Grant eligibility, means 12 or more semester units or the equivalent.

(g) "Expected family contribution," with respect to an applicant, shall be determined using the federal methodology pursuant to subdivision (a) of Section 69506 (as established by Title IV of the federal Higher Education Act of 1965, as amended (20 U.S.C. Sec. 1070 et seq.)) and applicable rules and regulations adopted by the commission.

(h) "High school grade point average" means a grade point average calculated on a 4.0 scale, using all academic coursework, for the sophomore year, the summer following the sophomore year, the junior year, and the summer following the junior year, excluding physical education, reserve officer training corps (ROTC), and remedial courses, and computed pursuant to regulations of the commission. However, for high school graduates who apply after their senior year, "high school grade point average" includes senior year coursework.

(i) "Instructional program of not less than one academic year" means a program of study that results in the award of an associate or baccalaureate degree or certificate requiring at least 24 semester units or the equivalent, or that results in eligibility for transfer from a community college to a baccalaureate degree program.

(j) "Instructional program of not less than two academic years" means a program of study that results in the award of an associate or baccalaureate degree requiring at least 48 semester units or the equivalent, or that results in eligibility for transfer from a community college to a baccalaureate degree program.

(k) "Maximum household income and asset levels" means the applicable household income and household asset levels for participants, including new applicants and renewing recipients, in the Cal Grant Program, as defined and adopted in regulations by the commission for the 2001-02 academic year, which shall be set pursuant to the following income and asset ceiling amounts:

CAL GRANT PROGRAM INCOME CEILINGS

	Cal Grant A, C, and T	Cal Grant B
Dependent and Independent students with dependents*		
Family Size		
Six or more	$74,100	$40,700
Five	$68,700	$37,700
Four	$64,100	$33,700
Three	$59,000	$30,300
Two	$57,600	$26,900
Independent		
Single, no dependents	$23,500	$23,500
Married	$26,900	$26,900

*Applies to independent students with dependents other than a spouse.

CAL GRANT PROGRAM ASSET CEILINGS

	Cal Grant A, C, and T	Cal Grant B
Dependent**	$49,600	$49,600
Independent	$23,600	$23,600

**Applies to independent students with dependents other than a spouse.

The commission shall annually adjust the maximum household income and asset levels based on the percentage change in the cost of living within the meaning of paragraph (1) of subdivision (e) of Section 8 of Article XIII B of the California Constitution. The maximum household income and asset levels applicable to a renewing recipient shall be the greater of the adjusted maximum household income and asset levels or the maximum household income and asset levels at the time of the renewing recipient's initial Cal Grant award. For a recipient who was initially awarded a Cal Grant for an academic year before the 2011-12 academic year, the maximum household income and asset levels shall be the greater of the adjusted maximum household income and asset levels or the 2010-11 academic year maximum household income and asset levels. An applicant or renewal recipient who qualifies to be considered under the simplified needs test established by federal law for student assistance shall be presumed to meet the asset level test under this section. Prior to disbursing any Cal Grant funds, a qualifying institution shall be obligated, under the terms of its institutional participation agreement with the commission, to resolve any conflicts that may exist in the data the institution possesses relating to that individual.

(l) (1) "Qualifying institution" means an institution that complies with paragraphs (2) and (3) and is any of the following:

(A) A California private or independent postsecondary educational institution that participates in the Pell Grant Program and in at least two of the following federal campus-based student aid programs:

(i) Federal Work-Study.

(ii) Perkins Loan Program.

(iii) Supplemental Educational Opportunity Grant Program.

(B) A nonprofit institution headquartered and operating in California that certifies to the commission that 10 percent of the institution's operating budget, as demonstrated in an audited financial statement, is expended for purposes of institutionally funded student financial aid in the form of grants, that demonstrates to the commission that it has the administrative capacity to administer the funds, that is accredited by the Western Association of Schools and Colleges, and that meets any other state-required criteria adopted by regulation by the commission in consultation with the Department of Finance. A regionally accredited institution that was deemed qualified by the commission to participate in the Cal Grant Program for the 2000-01 academic year shall retain its eligibility as long as it maintains its existing accreditation status.

(C) A California public postsecondary educational institution.

(2) (A) The institution shall provide information on where to access California license examination passage rates for the most recent available year from graduates of its undergraduate programs leading to employment for which passage of a California licensing examination is required, if that data is electronically available through the Internet Web site of a California licensing or regulatory agency. For purposes of this paragraph, "provide" may exclusively include placement of an Internet Web site address labeled as an access point for the data on the passage rates of recent program graduates on the Internet Web site where enrollment information is also located, on an Internet Web site that provides centralized admissions information for postsecondary educational systems with multiple campuses, or on applications for enrollment or other program information distributed to prospective students.

(B) The institution shall be responsible for certifying to the commission compliance with the requirements of subparagraph (A).

(3) (A) The commission shall certify by October 1 of each year the institution's latest three-year cohort default rate and graduation rate as most recently reported by the United States Department of Education.

(B) For purposes of the 2011-12 academic year, an otherwise qualifying institution with a three-year cohort default rate reported by the United States Department of Education that is equal to or greater than 24.6 percent shall be ineligible for initial and renewal Cal Grant awards at the institution, except as provided in subparagraph (F).

(C) For purposes of the 2012-13 academic year, and every academic year thereafter, an otherwise qualifying institution with a three-year cohort default rate that is equal to or greater than 15.5 percent, as certified by the commission on October 1, 2011, and every year thereafter, shall be ineligible for initial and renewal Cal Grant awards at the institution, except as provided in subparagraph (F).

(D) (i) An otherwise qualifying institution that becomes ineligible under this paragraph for initial and renewal Cal Grant awards shall regain its eligibility for the academic year for which it satisfies the requirements established in subparagraph (B), (C), or (G), as applicable.

(ii) If the United States Department of Education corrects or revises an institution's three-year cohort default rate or graduation rate that originally failed to satisfy the requirements established in subparagraph (B), (C), or (G), as applicable, and the correction or revision results in the institution's three-year cohort default rate or graduation rate satisfying those requirements, that institution shall immediately regain its eligibility for the academic year to which the corrected or revised three-year cohort default rate or graduation rate would have been applied.

(E) An otherwise qualifying institution for which no three-year cohort default rate or graduation rate has been reported by the United States Department of Education shall be provisionally eligible to participate in the Cal Grant Program until a three-year cohort default rate or graduation rate has been reported for the institution by the United States Department of Education.

(F) (i) An institution that is ineligible for initial and renewal Cal Grant awards at the institution under subparagraph (B), (C), or (G) shall be eligible for renewal Cal Grant awards for recipients who were enrolled in the ineligible institution during the academic year before the academic year for which the institution is ineligible and who choose to renew their Cal Grant awards to attend the ineligible institution. Cal Grant awards subject to this subparagraph shall be reduced as follows:

(I) The maximum Cal Grant A and B awards specified in the annual Budget Act shall be reduced by 20 percent.

(II) The reductions specified in this subparagraph shall not impact access costs as specified in subdivision (b) of Section 69435.

(ii) This subparagraph shall become inoperative on July 1, 2013.

(G) For purposes of the 2012-13 academic year, and every academic year thereafter, an otherwise qualifying institution with a graduation rate of 30 percent or less for students taking 150 percent or less of the expected time to complete degree requirements, as reported by the United States Department of Education and as certified by the commission, pursuant to subparagraph (A), shall be ineligible for initial and renewal Cal Grant awards at the institution, except as provided for in subparagraphs (F) and (I).

(H) Notwithstanding any other law, the requirements of this paragraph shall not apply to institutions with 40 percent or less of undergraduate students borrowing federal student loans, using information reported to the United States Department of Education for the academic year two years before the year in which the commission is certifying the three-year cohort default rate or graduation rate pursuant to subparagraph (A).

(I) Notwithstanding subparagraph (G), an otherwise qualifying institution with a three-year cohort default rate that is less than 10 percent and a graduation rate above 20 percent for students taking 150 percent or less of the expected time to complete degree requirements, as certified by the commission pursuant to subparagraph (A), shall remain eligible for initial and renewal Cal Grant awards at the institution through the 2016-17 academic year.

(J) The commission shall do all of the following:

(i) Notify initial Cal Grant recipients seeking to attend, or attending, an institution that is ineligible for initial and renewal Cal Grant awards under subparagraph (C) or (G) that the institution is ineligible for initial Cal Grant awards for the academic year for which the student received an initial Cal Grant award.

(ii) Notify renewal Cal Grant recipients attending an institution that is ineligible for initial and renewal Cal Grant awards at the institution under subparagraph (C) or (G) that the student's Cal Grant award will be reduced by 20 percent, or eliminated, as appropriate, if the student attends the ineligible institution in an academic year in which the institution is ineligible.

(iii) Provide initial and renewal Cal Grant recipients seeking to attend, or attending, an institution that is ineligible for initial and renewal Cal Grant awards at the institution under subparagraph (C) or (G) with a complete list of all California postsecondary educational institutions at which the student would be eligible to
receive an unreduced Cal Grant award.

(K) By January 1, 2013, the Legislative Analyst shall submit to the Legislature a report on the implementation of this paragraph. The report shall be prepared in consultation with the commission, and shall include policy recommendations for appropriate measures of default risk and other direct or indirect measures of quality or effectiveness in educational institutions participating in the Cal Grant Program, and appropriate scores for those measures. It is the intent of the Legislature that appropriate policy and fiscal committees review the requirements of this paragraph and consider changes thereto.

(m) "Satisfactory academic progress" means those criteria required by applicable federal standards published in Title 34 of the Code of Federal Regulations. The commission may adopt regulations defining "satisfactory academic progress" in a manner that is consistent with those federal standards.