OVERVIEW OF THE 2015-16 BUDGET BILL

Senate Bill 69
As Introduced January 9, 2015

Senator Committee on Budget and Fiscal Review
Senator Mark Leno, Chair

February 2015
Dear Colleague:

I am pleased to forward a copy of the *Overview of the 2015-16 Budget Bill*, which has been prepared by the staff of the Senate Committee on Budget and Fiscal Review. The document is intended to highlight the Governor’s major proposals and provide additional information and framework to support the review of these proposals. This document, together with other materials, will provide the basis for budget hearings throughout the spring.

In the first section, we provide an overview of the state’s fiscal condition and the Governor’s fiscal proposals. The next section, entitled “Major Issues,” is organized by budget subcommittee. For each major issue, this report provides background, an explanation of the Governor’s proposals, and important issues to consider.

In the Appendix, we include supplementary fiscal documents from the Department of Finance. Also included are a working timeline for completing the 2015-16 budget and a list of budget committee consultants and their respective areas of responsibility.

If you have questions, please do not hesitate to contact me or the committee staff.

Sincerely,

MARK LENO
Chair
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INTRODUCTION

The Governor proposed a budget for 2015-16 which includes resources—carry-forward balance, revenues and transfers—of $114.8 billion and expenditures of $113.3 billion. Based on the budget proposal, the General Fund would end the 2015-16 year with a general reserve of almost $1.5 billion (less approximately $1.0 billion reserved for encumbrances). It would also include the deposit of $1.2 billion to the Budget Stabilization Account (BSA), resulting in an expected balance in this account of $2.8 billion. The budget also includes the continuation of established efforts—reinforced by the passage of Proposition 2 last November—to pay down budgetary debt from past years. The fiscal position of the 2015-16 budget benefits from past years of spending restraint, temporary taxes approved by the voters in 2012, and a steadily improving state economy resulting in increasing revenues.

As a result of the combined efforts of the Legislature and the Administration, the General Fund continues to be in a very solid position. In the current year, the fiscal position of the state is expected to be substantially better than when the budget was adopted in June. From the 2014-15 adopted budget, revenues are up by about $4 billion over the three-year period (past year, current year and budget year). The General Fund’s comparative health follows from last year’s good budgetary news. The proposed 2015-16 budget builds from this solid base, incorporating a total unencumbered reserve—Special Fund for Economic Uncertainties (SFEU) plus BSA—of approximately $3.3 billion, and includes a $1.2 billion pay-down of budget debt. Overall, General Fund spending in 2015-16 is expected to grow in percentage terms only slightly from 2014-15 to 2015-16, largely due to a big boost in education spending in the current year from additional revenues. The proposed budget continues the Administration’s focus on paying off budgetary debt and building up the state’s reserve.
OVERVIEW OF GOVERNOR’S BUDGET PROPOSAL

The Governor’s budget includes $114.8 billion in General Fund revenues and other resources and $113.3 billion in total General Fund expenditures (with spending of $66.3 billion in non-Proposition 98 and $47.0 billion in Proposition 98). It also provides for a $534 million unencumbered reserve in the SFEU as well as setting aside an additional $1.2 billion for the BSA. Expenditures in 2015-16 are proposed to be about $1.6 billion higher than revised 2014-15 expenditures. Significant additional funding is proposed for K-14 education, higher education, and debt repayment, with some increases for health and human services, and corrections and rehabilitation. Additional resources that have allowed for measured expansions and workload growth are the result of very positive revenue increases based on the general economic upturn. The General Fund budget summary data are shown in the table below:

<table>
<thead>
<tr>
<th>2014-15 and 2015-16 General Fund Summary (Dollars in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revised 2014-15</strong></td>
</tr>
<tr>
<td>PRIOR YEAR BALANCE</td>
</tr>
<tr>
<td>Revenues and transfers</td>
</tr>
<tr>
<td>TOTAL RESOURCES AVAILABLE</td>
</tr>
<tr>
<td>Non-Proposition 98 Expenditures</td>
</tr>
<tr>
<td>Proposition 98 Expenditures</td>
</tr>
<tr>
<td>TOTAL EXPENDITURES</td>
</tr>
<tr>
<td>FUND BALANCE</td>
</tr>
<tr>
<td>Encumbrances</td>
</tr>
<tr>
<td>Special Fund for Economic Uncertainties</td>
</tr>
<tr>
<td>BUDGET STABILIZATION ACCOUNT</td>
</tr>
</tbody>
</table>

Source: Department of Finance
The Governor’s budget represents the third consecutive budget that does not incorporate significant program reductions. As a result of the Legislature’s efforts and the voters’ approval of temporary taxes, the state continues to be on a relatively firm fiscal footing. Measures taken in past years to close the budget gap have been significant and the effect on General Fund spending has reflected the severe economic and fiscal constraints. Prior to the recent fiscal upturn, General Fund spending last peaked in 2007-08 at $103.0 billion, dropping to $90.4 billion in 2008-09 and to $86.4 billion in 2011-12. The current year represents the fourth time General Fund revenues have increased since the recession began.

Despite the recovery and fiscal strength the state now enjoys, some budgetary impacts remain. The economic and fiscal downturn, from which some state programs continue to recover, began in full-force in 2008 with the rapid drop in economic activity and the subsequent onset of the recession. This led to sharp declines in revenue—especially from economically sensitive components—and escalating expenditure demands for particular programs and services. Prior budget decisions, including permanent tax reductions, left the state facing budgetary obstacles with reduced fiscal flexibility, coupled with pressures to adopt one-time solutions to address ongoing structural imbalances. The following sections describe the budgetary evolution over the last few years.

Prior to the Recession. Before 2008, there was some evidence of possible budget stress; in the fall of 2006, the Legislative Analyst’s Office (LAO) raised concerns regarding the state’s structural balance in the out-years. Even so, the state’s General Fund was expected to end the 2006-07 budget year with a reserve of $3.1 billion. Based on continuing revenue improvements at the time—especially stronger than expected investment income—this actually represented an increase of about $1.0 billion from the estimated reserve in the 2006 Budget Act. The LAO did raise concerns regarding the outlook for the 2007-08 budget year, indicating that operating expenditures would outstrip operating revenues by roughly $5.5 billion.

2007 Budget Act. By the fall of 2007, there was additional deterioration in the state’s budget situation. The economy was beginning to soften somewhat, leading to modest revenue declines. A leveling off in the rapid run-up of property taxes led to increasing General Fund expenditures on K-14 education. When the 2007 Budget Act was adopted in August, the focus was on closing a modest budget gap and retaining a $4.1 billion reserve which was then forecasted. However, by the fall of 2007, the budget situation had deteriorated by about $6.0 billion and a current year deficit of $1.9 billion was expected. The outlook for the 2008-09 budget was even worse; the LAO indicated an operating shortfall of $8.0 billion and multi-billion dollar shortfalls thereafter.

2008 Budget Act. When the 2008 Budget Act was adopted in September, the prior year shortfall and the budget had been addressed largely through a series of one-time measures. The 2008 Budget Act incorporated a reserve of $1.7 billion for 2008-09. Within weeks of the budget passing, however, national financial and credit markets virtually collapsed, leading to substantial declines in state revenues. By the fall of 2008, LAO forecasted a current year shortfall of $8.4 billion, representing a precipitous reversal of $10.0 billion from the time the budget was adopted.
in September, and reflective of the free-fall in the state and national economies. Furthermore, the LAO indicated a $19.4 billion deficit for 2009-10, for a massive combined two-year deficit of $27.8 billion. Absent corrective action, huge shortfalls in the out-years were also forecasted.

2009 Budget Act. The Budget Act of 2009 was comprised of multiple legislative actions throughout the year. Revisions were made to the 2008-09 budget year as well, with major temporary tax increases and significant cuts affecting most state-funded programs. At the time of the July 2009 revisions to the budget act, the plan incorporated a $500 million reserve at the conclusion of the 2009-10 budget year and a deficit in 2010-11 of $7.4 billion. However, by the fall of 2009, the situation had continued to deteriorate, and LAO forecasted a current year deficit of $6.3 billion, coupled with a $14.4 billion shortfall in 2010-11, for a two-year budget gap of $20.7 billion.

2010 Budget Act. The Legislature adopted the 2010 Budget Act in October 2010 with an estimated reserve for the 2010-11 budget year of $1.3 billion, and predicated on the receipt of $3.5 billion in federal funds. In its fall 2010 analysis, LAO assumed these additional federal dollars would not be received and also incorporated other erosions in savings and or revenues in projecting a shortfall in 2010-11 of $6.1 billion. In addition, the slow economic recovery and the temporary nature of some of the budget-balancing measures meant that the state would show an additional shortfall in 2011-12 of approximately $19.2 billion. Despite the still substantial budget deficits, this was actually the first time since the downturn began that the estimates for the out-year deficit had declined from the prior year’s estimated shortfall.

2011 Budget Act. By the following year, adopted on-going budget solutions were taking hold in a substantial manner. Still, in the fall of 2011, the LAO indicated a shortfall of $3.0 billion 2011-12, as opposed to a surplus of $500 million incorporated in the 2011 Budget Act. This prognosis was the result of additional declines in prior year revenues, continuing economic softness in the current year, and the inability to realize certain savings as a result of court decisions. The 2011 Budget Act incorporated a series of trigger cuts that would occur if revenues did not reach a certain level. Even with the assumed trigger cuts, it was expected that the state would still face a 2011-12 shortfall of $3.0 billion, coupled with a 2012-13 operating shortfall of $9.8 billion. The state ended the 2011-12 budget year with a deficit of $3.6 billion.

2012 Budget Act. The 2012 Budget Act, adopted in June 2012, included significant expenditure reductions and a reliance on proposed temporary taxes. The Governor’s budget addressed the shortfall through budget-balancing solutions of $10.3 billion—including a $1.1 billion reserve. By May, the budget situation had deteriorated and the deficit had increased to $16.7 billion for the period ending June 30, 2013. This was due to a reduced revenue outlook, higher costs to fund schools, and decisions made by the federal government and courts to block budget cuts. In early June, the Legislature adopted a budget that included most of the Governor’s May Revision framework, relying primarily on additional expenditure reductions, as well as passage of a tax initiative on the November 2012 ballot. The budget plan contained $16.6 billion in total solutions for the period ending June 30, 2013, including $8.1 billion in expenditure reductions, $6.0 billion in additional revenues, and $2.5 billion in other solutions. The 2012-13 budget assumed that 2012-13 would end with a $254 million reserve. An increase in K-12 funding reduced this surplus slightly. This represented the first state reserve since 2007-08.
2013 Budget Act. The 2013-14 budget, adopted in June 2013, contained measured increases in expenditures from the prior year, with relatively isolated restorations in selected areas. The Governor’s proposed budget included $98.5 billion in General Fund revenues and expenditures of $97.7 billion. The Administration estimated that a $2.4 billion surplus would be sufficient to erase the 2011-12 deficit of $2.2 billion and projected that the $167 million ending balance and an $851 million operating surplus in 2013-14, would produce a reserve in 2013-14 of approximately $1.0 billion. By May, the budget situation had improved modestly, according to Department of Finance (DOF) projections, largely as a result of somewhat improved revenue estimates. The adopted budget resulted in a 2012-13 reserve of $254 million and a 2013-14 reserve of approximately $1.1 billion. Additional spending on corrections, approved by the Legislature in August, reduced the expected reserve to approximately $700 million.

CURRENT-YEAR BUDGET HIGHLIGHTS AND UPDATE

In the current year, working from the general basis of the Governor’s budget and May Revision, the Legislature incorporated significant and important budgetary and policy changes to the state’s expenditure plan. In general, the budget reflected the framework of the Governor’s budget, but incorporated Legislative priorities as established through the spring budgetary process. The 2014 Budget Act signed by the Governor maintained the overall fiscal framework of the Governor’s proposal, with conservative revenue estimates, continued debt retirement, a projected balanced approach in the out-years, and a $2.1 billion reserve.

Expenditure Highlights. The 2014-15 budget allowed for additional investments in non-Proposition 98 and Proposition 98 expenditures. These included:

- **Human Services.** The budget plan provided an increase of $66 million (and additional amounts in future years) for In-Home Supportive Services (IHSS) to pay caretaker overtime, pursuant to federal regulation. The enacted budget included $100 million for childcare services as part of the early childhood education initiative (along with additional resources within Proposition 98). It also included $44 million for CalWORKs, $8 million to restore eligibility in the Early Start Program for infants and toddlers at risk of having a developmental disability and $5 million for additional services to combat child sexual exploitation.

- **Health Services.** In the health area, the budget provided $1.8 million for rate increases for Medi-Cal’s Program for All-Inclusive Care for the Elderly (PACE), $4 million for the Black Infant Health Program, and $3 million for HIV prevention demonstration projects.

- **Courts, Corrections and Housing.** The budget added $100 million for affordable housing on a one-time basis, consisting of $50 million for multifamily housing, which provides affordable housing for low-income families, and $50 million for the multifamily supportive-housing program, which is focused on providing permanent housing for individuals who are either homeless or very low-income. The budget allocated an additional $40 million to the state court system. In addition, the plan significantly shifted the allocation of resources in the Recidivism Reduction Fund that was included in the Governor’s May Revision.
• **Higher Education.** The 2014-15 budget increased higher education resources by $39 million for Cal Grant programs—Private and Cal Grant B, and $30 million for disabled student services programs. In addition, there was a trigger for an additional $100 million for maintenance in the event property taxes exceeded the level forecast by the Administration in the May Revision. (This additional funding was not triggered).

• **Proposition 98 Education Expenditures.** Under the budget, resources were used to make important new educational investments, including:
  
  o **Early Childhood Education.** The budget made significant improvements in early childhood education (ECE), through a multiyear investment in early learning and care systems, including restoration of lost slots in current ECE programs, modernized rates for service, increased pre-kindergarten opportunities for low-income 4-year-olds, and improved program quality. The budget included $70 million to increase rates, and $85 million for facilities and quality grants.
  
  o **Local Control Funding Formula.** The budget plan set aside an additional $250 million in Proposition 98 resources, above the Governor’s $4.5 billion, to accelerate the full implementation of the Local Control Funding Formula (LCFF). These unrestricted resources provide additional support for local educational agencies program needs in a variety of areas, including the additional contributions required for unfunded liabilities associated with the California State Teachers Retirement System (CalSTRS).
  
  o **Career Pathways.** Included in the budget was a reinvestment in programs meant to build stronger connections between our schools and businesses, to better prepare students for the changing job market by placing a greater emphasis on career-based learning. The approved budget appropriated an additional $250 million to capitalize the California Career Pathways Trust.
  
  o **Unpaid Mandates.** The budget provided a down-payment of $450 million on mandate claims owed to school districts and community colleges, consistent with the Proposition 98 package. These funds can be used as additional resources to support the implementation of the Common Core curriculum.
  
  o **Pay-down of Deferrals.** The 2014-15 budget incorporated the substance of the Governor’s January K-14 deferral pay-down plan, as adjusted by the May Revision, but reduced the deferral pay down from $6.2 billion to $5.2 billion. This reduced the so-called “wall-of-debt” and eased cash flow for school districts and community college districts. General Fund revenues received that are above the forecasted amounts would trigger additional deferral payments.

**Recent Developments.** Since the budget was adopted, there have been several spending adjustments—particularly in the education and health and human services areas—as well as significant improvements from the revenues adopted in the budget. The difference between the adopted and revised current year budget are presented below.
General Fund Expenditures  
Current Year Adopted and Revised  
(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Education</td>
<td>$44,980</td>
<td>$47,121</td>
<td>$2,141</td>
<td>4.7%</td>
</tr>
<tr>
<td>Higher Education</td>
<td>$12,562</td>
<td>$12,947</td>
<td>$385</td>
<td>3.1%</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>$29,652</td>
<td>$30,490</td>
<td>$838</td>
<td>2.8%</td>
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<tr>
<td>Corrections and Rehabilitation</td>
<td>$9,590</td>
<td>$9,995</td>
<td>$405</td>
<td>4.2%</td>
</tr>
<tr>
<td>Business, Consumers, Housing</td>
<td>$850</td>
<td>$839</td>
<td>-$11</td>
<td>-1.3%</td>
</tr>
<tr>
<td>Transportation</td>
<td>$216</td>
<td>$158</td>
<td>-$58</td>
<td>-26.9%</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>$2,260</td>
<td>$2,497</td>
<td>$237</td>
<td>10.5%</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>$63</td>
<td>$78</td>
<td>$15</td>
<td>23.8%</td>
</tr>
<tr>
<td>Labor and Workforce Development</td>
<td>$303</td>
<td>$282</td>
<td>-$21</td>
<td>-6.9%</td>
</tr>
<tr>
<td>Government Operations</td>
<td>$692</td>
<td>$730</td>
<td>$38</td>
<td>5.5%</td>
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<td>General Government</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Agency Departments</td>
<td>$715</td>
<td>$1,267</td>
<td>$552</td>
<td>77.2%</td>
</tr>
<tr>
<td>Tax Relief / Local Government</td>
<td>$442</td>
<td>$446</td>
<td>$4</td>
<td>0.9%</td>
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<tr>
<td>Statewide Expenditures</td>
<td>$1,088</td>
<td>$256</td>
<td>-$832</td>
<td>-76.5%</td>
</tr>
<tr>
<td>Legislative, Judicial and Executive</td>
<td>$2,968</td>
<td>$3,007</td>
<td>$39</td>
<td>1.3%</td>
</tr>
<tr>
<td>Supplemental ERB Payment</td>
<td>$1,606</td>
<td>$1,606</td>
<td>$0</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$107,987</strong></td>
<td><strong>$111,719</strong></td>
<td><strong>$3,732</strong></td>
<td><strong>3.5%</strong></td>
</tr>
</tbody>
</table>

Source: Department of Finance

BUDGET YEAR PROPOSED EXPENDITURES

Like the current year, the proposed budget incorporates additional, but restrained, new programmatic increases. The table below summarizes the Governor’s proposed expenditures by program area. The most noteworthy changes are in higher education, where the Governor proposes funding last year’s agreement, and in human services. K-12 education receives a big boost over the three year period, but the large growth in the current year swamps the effect in the budget year. Because the ERBs are largely paid off in the current year, this results in a large $1.6 billion expenditure drop.
The Governor’s budget proposes some major policy and budgetary changes. Some of the more important aspects of the budget proposal are outlined below:

**Education**

**Funding Levels.** The budget proposes to continue investments in both K-12 schools and higher education. Increasing revenues in 2015-16 will result in an additional $8 billion for Proposition 98 over the three-year period. The key changes in the education area include:

- **K-12 Schools.** Per student funding levels will increase to $13,562 in 2015-16 from $13,223 in 2014-15 (and from $12,248 in 2013-14). Proposition 98 funding will increase from $58.7 billion in 2013-14 to $63.2 billion in 2014-15 to $65.7 billion in 2015-16. Rising state revenues means that the state can continue implementing the Local Control Funding Formula ahead of schedule. When the formula was adopted in 2013-14, funding was expected to be $47 billion in 2015-16. The budget provides almost $4 billion more—with the formula instead allocating $50.7 billion this coming year.

- **Higher Education.** The budget provides continuing additional funding to the state’s higher education system to help maintain its quality and affordability. The budget includes stable funding growth designed to eliminate the need for further tuition increases.

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**General Fund Expenditures**

**Current and Budget Year**

**(Dollars in Millions)**

<table>
<thead>
<tr>
<th>Program Area</th>
<th>Revised 2014-15</th>
<th>Proposed 2015-16</th>
<th>Change</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Education</td>
<td>$47,121</td>
<td>$47,173</td>
<td>$52</td>
<td>0.1%</td>
</tr>
<tr>
<td>Higher Education</td>
<td>$12,947</td>
<td>$14,063</td>
<td>$1,116</td>
<td>8.6%</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>$30,490</td>
<td>$31,929</td>
<td>$1,439</td>
<td>4.7%</td>
</tr>
<tr>
<td>Corrections and Rehabilitation</td>
<td>$9,995</td>
<td>$10,160</td>
<td>$165</td>
<td>1.7%</td>
</tr>
<tr>
<td>Business, Consumers, Housing</td>
<td>$839</td>
<td>$639</td>
<td>-$200</td>
<td>-23.8%</td>
</tr>
<tr>
<td>Transportation</td>
<td>$158</td>
<td>$237</td>
<td>$79</td>
<td>50.0%</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>$2,497</td>
<td>$2,561</td>
<td>$64</td>
<td>2.6%</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>$78</td>
<td>$68</td>
<td>-$10</td>
<td>-12.8%</td>
</tr>
<tr>
<td>Labor and Workforce Development</td>
<td>$282</td>
<td>$265</td>
<td>-$17</td>
<td>-6.0%</td>
</tr>
<tr>
<td>Government Operations</td>
<td>$730</td>
<td>$701</td>
<td>-$29</td>
<td>-4.0%</td>
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<tr>
<td>General Government</td>
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<td></td>
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</tr>
<tr>
<td>Non-Agency Departments</td>
<td>$1,267</td>
<td>$676</td>
<td>-$591</td>
<td>-46.6%</td>
</tr>
<tr>
<td>Tax Relief / Local Government</td>
<td>$446</td>
<td>$444</td>
<td>-$2</td>
<td>-0.4%</td>
</tr>
<tr>
<td>Statewide Expenditures</td>
<td>$256</td>
<td>$1,251</td>
<td>$995</td>
<td>388.7%</td>
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<tr>
<td>Legislative, Judicial and Executive</td>
<td>$3,007</td>
<td>$3,131</td>
<td>$124</td>
<td>4.1%</td>
</tr>
<tr>
<td>Economic Recovery Bonds Payment</td>
<td>$1,606</td>
<td>$0</td>
<td>-$1,606</td>
<td>-100.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$111,719</strong></td>
<td><strong>$113,298</strong></td>
<td><strong>$1,579</strong></td>
<td><strong>1.4%</strong></td>
</tr>
</tbody>
</table>

Source: Department of Finance
and intends to have community colleges and university systems work together to help ensure students complete their degrees in a timely manner.

**Adult Education.** The Governor’s budget proposes to provide $500 million in Proposition 98 funding for a new Adult Education Block Grant. In 2013-14 and 2014-15, K-12 districts had a maintenance-of-effort (MOE) requirement to continue to spend the same amount of funding on adult education as in 2012-13. In addition, the 2013 Budget Act provided $25 million in two-year planning grants to community colleges and K-12 consortia for adult education. This Governor’s budget proposal is intended to build off of the last two years and fund adult education programs through regional consortia.

**Career Technical Education.** The Governor’s budget proposes to provide $250 million in one-time Proposition 98 funding in each of the next three years for a Career Technical Education (CTE) Incentive Grant Program. This program would provide funding for school districts, charter schools, and county offices of education to develop and expand CTE programs. Grantees would be required to provide matching funds and demonstrate positive results on CTE-related outcomes over time. Priority for funding would be given to regional partnerships. This marks a change from efforts to fund CTE programs in prior years. Specifically, in 2013-14 and 2014-15, K-12 districts had a MOE requirement to continue to spend the same amount of funding on CTE as in 2012-13. The 2013 and 2014 budget acts also provided $250 million each year in one-time Proposition 98 funding for the Career Pathways Trust Program to provide one-time competitive grants for CTE programs.

**Health Care.** The Governor proposes to continue the Managed Care Organization (MCO) tax. The state’s current MCO tax offsets $803 million in General Fund expenditures in 2014-15 and $1.1 billion in 2015-16. The budget proposes a new, broad-based MCO tax that complies with federal law. The new proposal is intended to offset the same amount of General Fund expenditures as the current tax, as well as fund a restoration of the seven percent reduction of IHSS hours required by a settlement agreement for two class-action lawsuits.

**Natural Resources.** The budget includes multiple water proposals including a spend-down of Proposition 1E flood funds ($1.1 billion), allocation of $532 million from the new water bond (Proposition 1) for various water supply and quality programs, continued funding of the Water Action Plan (about $14.7 from multiple funding sources), and finally continued drought response ($115 million, of which $93.5 million is General Fund) should the Governor declare a continued drought.

**Unfunded Liabilities.** Under the Governor’s budget, $1.9 billion will be paid to the California State Teachers Retirement System (CalSTRS), representing an increase in state contributions to address the unfunded liability pursuant to last year’s agreement. Along with participation by employees and employers, the plan is designed to eliminate the approximately $74 billion unfunded liability in 30 years. In addition, the budget proposes to begin addressing the $72 billion unfunded liability that exists for retiree health care benefits by phasing in greater employee cost-sharing as labor contracts come up for renewal. It is anticipated that employees and employers would equally share in the prefunding of retiree health costs. Under this plan, retiree health care benefits are preserved and investment returns will help pay for future benefits, to eventually eliminate the unfunded liability by 2044-45.
Budget Reserve. As approved by the voters through Proposition 2 in November, the state has improved the BSA by strengthening the requirements to deposit funds and making withdrawals subject to greater controls. The BSA is now funded through a deposit of equal to 1.5 percent of General Fund revenues plus capital gains revenues in excess of eight percent of General Fund revenues. Under certain conditions, a Proposition 98 school reserve would also be funded. As an integral part of the Governor’s proposal, the budget includes measures that would result in a deposit to the BSA. The deposit to the BSA, redefined by Proposition 2, will total $1.2 billion. This will result in a balance in the account at the conclusion on 2015-16 of $2.8 billion, when combined with the existing $1.6 billion in the BSA.

Budgetary Debt. The budget continues to pay down the budgetary debt overhang inherited from the prior Administration. Under the proposal, $1.2 billion in Proposition 2 funds will pay off loans from special funds and prior Proposition 98 liabilities. In addition, the budget repays the $1 billion in remaining school deferrals, makes the final payment on the ERBs. The current year budget is expected to repay $533 million in local government mandate reimbursements.

STATE ECONOMY AND REVENUES

Economic Outlook. Economic forecasts play an integral role in the state’s revenue forecast and fiscal outlook. The state’s revenue structure is very ‘elastic’, meaning it is highly sensitive to economic changes. This is particularly true for personal income tax receipts, which tend to grow (or decline) proportionally more than increases (or decreases) in the underlying income base. The sales and use tax, the second largest state revenue source, is sensitive to consumer confidence and consumption patterns. The property tax—which benefits the General Fund through additional resources for K-12 education—reacts to changes in the underlying property asset values and home sale prices.

The Governor and the LAO both forecast continued improvement in the overall modest—but generally steady—growth in the economy, and accompanying increases state revenues. The state’s recovery has gained momentum as a result of better real estate conditions, faster job growth, and improved consumer attitudes. Nationally and in California, concerns remain about labor participation—which continues to languish—and wage gains—which have shown scant improvement. The Administration’s economic forecast assumes that the current moderate economic recovery (annual growth of below three percent) will continue in 2015, leading to broad-based improvements in both the U.S. and California economies over the next two years. The assumed growth rates for the U.S. and California are equivalent to rates of improvement in a mature economic expansion, reflecting the consensus outlook that U.S. economic growth is returning to more normal levels.

The Administration expects job growth to improve, with employment projected to grow 2.0 percent in 2014 and 2.6 percent in 2015. Based on its November 2014 Fiscal Outlook, the LAO estimate is in the same range, with projected growth rates in employment of 2.2 percent and 2.1 percent for these two years. The Governor’s budget assumes a continued improvement in personal income with increases of 4.4 percent in 2014 and 4.5 percent in 2015. The LAO sees somewhat greater growth in personal income in 2014, with an increase of 4.9 percent, and 2015,
with an increase of 4.8 percent. The unemployment rate has dropped to 7.2 percent in November 2014 and is expected to fall to 6.3 percent by the end of 2015. Housing sector activity has been slower than anticipated, based on the adopted budget, with permits issued in the first three quarters of 2014 lower than the corresponding 2013 period; growth is expected to resume in 2015 and through the forecast period. Overall, the Administration’s and LAO’s economic forecasts are generally congruent.

**General Fund Revenues.** California relies on a broad range of taxes and other revenues to support the activities of the General Fund; however, the personal income tax, sales and use tax, and corporation taxes account for over 96 percent of General Fund revenues. For the budget year, the personal income tax is expected to generate $75.2 billion (67 percent), the sales and use tax $25.2 billion (22 percent), and the corporation tax $10.2 billion (9 percent). For the current year, income taxes are expected to perform strongly. Rapid expansion is expected to occur for the personal income tax, due largely to capital gains realizations and other non-wage income. Even the corporation tax, which has been weak, is expected to recover somewhat. Sales and use tax revenues are down by $1.4 billion from the 2014 Budget Act, but display estimated growth in the budget year.

Over the three year period, General Fund revenues are up by approximately $4.1 billion from the 2014 Budget Act. The revised forecast for the prior year, 2013-14 is the first forecast to exceed the pre-recession revenue peak in 2007-08. From the current year to budget year, the major revenue sources are expected to grow by 4.9 percent for the personal income tax, 7.4 percent for the sales and use tax, and 5.8 percent for the corporation tax. Overall year-to-year revenue growth is estimated to be 4.9 percent. The table below presents the state’s General Fund revenues for the current and budget year. See also the section on Revenues and Taxation for additional information regarding the state’s revenue system.

### General Fund Revenues

**Current Year Revised and Budget Year Forecast**

(Dollars in Millions)

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>2014-15</th>
<th>2015-16</th>
<th>Change</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income Tax</td>
<td>$71,699</td>
<td>$75,213</td>
<td>$3,514</td>
<td>4.9%</td>
</tr>
<tr>
<td>Sales and Use Tax</td>
<td>$23,438</td>
<td>$25,166</td>
<td>$1,728</td>
<td>7.4%</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>$9,618</td>
<td>$10,173</td>
<td>$555</td>
<td>5.8%</td>
</tr>
<tr>
<td>Insurance Tax</td>
<td>$2,490</td>
<td>$2,531</td>
<td>$41</td>
<td>1.6%</td>
</tr>
<tr>
<td>Alcohol Beverage Tax</td>
<td>$367</td>
<td>$374</td>
<td>$7</td>
<td>1.9%</td>
</tr>
<tr>
<td>Cigarette Tax</td>
<td>$84</td>
<td>$82</td>
<td>-$2</td>
<td>-2.4%</td>
</tr>
<tr>
<td>Motor Vehicle Fees</td>
<td>$20</td>
<td>$21</td>
<td>$1</td>
<td>5.0%</td>
</tr>
<tr>
<td>Other Taxes and Fees</td>
<td>$1,932</td>
<td>$1,040</td>
<td>-$892</td>
<td>-46.2%</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$109,648</td>
<td>$114,600</td>
<td>$4,952</td>
<td>4.5%</td>
</tr>
<tr>
<td>Transfer to Reserve</td>
<td>-$1,606</td>
<td>-$1,220</td>
<td>$386</td>
<td>-24.0%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$108,042</td>
<td>$113,380</td>
<td>$5,338</td>
<td>4.9%</td>
</tr>
</tbody>
</table>

Source: Department of Finance
SUBCOMMITTEE NO. 1

EDUCATION

K-12 Education
- K-12 Finance & Accountability: Local Control Funding Formula ......................................... 1-1
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K-12 Finance & Accountability: Local Control Funding Formula

BACKGROUND

K-12 School Finance Reform. As of the 2014 Budget Act, the state appropriates more than $55 billion in Proposition 98 funding (General Fund and local property taxes) annually for K-12 public schools. As part of the 2013-14 budget, the state significantly reformed the system for allocating most of these resources to school districts, charter schools, and county offices of education. Specifically, the new Local Control Funding Formula (LCFF) replaced the state’s prior system of distributing funds to local education agencies (LEAs) through revenue limit apportionments (based on per student average daily attendance) and approximately 50 state categorical education programs.

Under the old system, revenue limits provided LEAs with discretionary (unrestricted) funding for general education purposes, and categorical program (restricted) funding was provided for specialized purposes, with each program having unique allocation and spending requirements. Revenue limits made up about two-thirds of state funding for schools, while categorical program funding made up the remaining one-third portion. For some time, that system was criticized as being too state-driven, bureaucratic, complex, inequitable, and based on outdated allocation methods that did not reflect current student needs.

In his budgets for 2012-13 and 2013-14, Governor Brown proposed a new school finance formula. His proposal in 2012-13, for a Weighted Pupil Formula, was not adopted by the Legislature. In 2013-14, the Governor proposed the LCFF with the goals to:

- Increase local control and reduce state bureaucracy.
- Ensure that student needs drive the allocation of resources.
- Increase transparency in school funding, empowering parents and local communities to access information in a more user-friendly manner and enhance their ability to engage in local school matters.
- Ensure sufficient flexibility and accountability at the local level so those closest to the students can make the decisions.

The specifics of the Governor’s proposal evolved over those two years, while the Legislature considered important aspects of such a major finance reform, including a new accountability structure for the funding. In adopting the LCFF, the Legislature embraced the principal tenets and elements of the Governor’s proposal but also refined the funding formula and the accountability framework.
Local Control Funding Formula. The LCFF combines the prior funding from revenue limits and more than 30 categorical programs that were eliminated, and uses new methods to allocate these resources and future allocations to school districts, charter schools, and county offices of education, allowing LEAs much greater flexibility in how they spend the funds than under the prior system. There is a single funding formula for school districts and charter schools, and a separate funding formula for county offices of education that has some similarities to the district formula, but also some key differences.

The LCFF includes new requirements for local planning and accountability that focus on improving student outcomes in state educational priorities and ensuring engagement of parents, students, teachers, school employees, and the public in the local process. In addition, the LCFF features a new system of support and intervention for underperforming school districts that do not meet their goals for improving student outcomes.

Fiscal Impact. The LCFF establishes new “target” LCFF funding amounts for each LEA, and these amounts will be adjusted annually for COLAs and pupil counts. Funding all school districts and charter schools at their target levels was expected to take eight years, with completion by 2020-21, when the formula was initially introduced. The Department of Finance (DOF) has not released an updated estimate at this point. County offices of education reached their target funding levels in 2014-15.

Over the past two years, the state has made considerable investments towards implementing the LCFF, the 2013-14 budget provided an increase of $2.1 billion in Proposition 98 funding for schools to begin LCFF implementation and an additional $4.75 billion was provided in the 2014-15 budget. The 2014-15 funding closed more than 29 percent of the remaining gap to full funding of the LCFF target levels for school districts and charter schools and brought county offices of education to full implementation. The remaining gap is recalculated annually based on funding provided but also annual adjustments to the LCFF funding targets.

School Districts and Charter Schools Formula. This formula is designed to provide districts and charter schools with the bulk of their resources in unrestricted funding to support the basic educational program for all students, plus supplemental funding, based on the enrollment of educationally-disadvantaged students (low-income students, English learners, and foster youth), provided for increasing or improving services to these high-needs students. Major components of the formula are briefly described below. (The committee’s Final Action Report on the 2013-14 budget contains detailed descriptions of the formula for districts and charter schools and the formula for county offices of education.)

- **Base Grants** are calculated on a per-pupil basis (measured by student average daily attendance) according to grade span (K-3, 4-6, 7-8, and 9-12) with adjustments that increase the base rates for grades K-3 (10.4 percent of base rate) and grades 9-12 (2.6 percent of base rate). The adjustment for grades K-3 is associated with a requirement to reduce class sizes in those grades to no more than 24 students by 2020-21, unless other agreements are collectively bargained at the local level. The adjustment for grades 9-12 recognizes the additional cost of providing career technical education in high schools.
• **Supplemental Grants** provide an additional 20 percent in base grant funding for low-income students, English learners, and foster youth (unduplicated pupil count).

• **Concentration Grants** provide an additional 50 percent above base grant funding for low-income students, English learners, and foster youth that exceed 55 percent of total enrollment.

• **Categorical Program** add-ons for Targeted Instructional Improvement Block Grant and Home-to-School Transportation provide districts the same amount of funding they received for these two programs in 2012-13. The transportation funds must be used for transportation purposes. Charter schools are not eligible for these add-ons.

• **LCFF Economic Recovery Target** add-on ensures that districts receive, in 2020-21, at least the amount of funding they would have received under the old finance system to restore funding to their 2007-08 level adjusted for inflation. Districts are not eligible for this add-on if their LCFF funding exceeds the 90th percentile of per-pupil funding rates estimated under the old system.

• **Hold Harmless Provision** ensures that no school district or charter school will receive less funding under the LCFF than its 2012-13 funding level.

**Restrictions on Supplemental Funding**

Statute requires LEAs to increase or improve services for educationally-disadvantaged students (low-income students, English learners, and foster youth) in proportion to the supplemental funding LEAs receive for the enrollment of these students. The law also allows this funding to be used for school-wide and district-wide purposes. The law requires the State Board of Education (SBE) to adopt regulations governing a LEA’s expenditure of this supplemental funding. On January 16, 2014, the SBE adopted LCFF emergency regulations, including these spending regulations, and adopted the permanent regulations on November 14, 2014. The regulations were approved by the Office of Administrative Law on January 6, 2015.

The regulations require a LEA to increase or improve services for educationally-disadvantaged students, as compared to the services provided for all students, in proportion to the supplemental funding LEAs receive for the enrollment of these students. The regulations allow an LEA to meet this requirement in a qualitative or quantitative manner. In addition, the LEA is required to detail these expenditures in their local control and accountability plan (LCAP), discussed below, and must include a description of how the expenditures improve outcomes for educationally-disadvantaged students in the state priority areas. The regulations also provide a formula to determine a proportionality percentage. Finally, the regulations authorize district-wide, school-wide, county-wide, and charter-wide expenditures of funds. LEAs with enrollment of educationally-disadvantaged students over 55 percent in a school district and over 40 percent in a school, may expend funds district-wide or school-wide if they provide a description of how these funds are principally directed towards, and effective in meeting goals in, the state priority areas for educationally-disadvantaged students. If a school district or school is under these enrollment thresholds, they must additionally describe how this is the most effective use of the funds.
Charter-wide and countywide expenditures must meet the same requirements as districts above the enrollment threshold.

**Local Control and Accountability Plans (LCAP).** To ensure accountability for LCFF funds, the state mandated that all school districts, charter schools, and county offices of education annually adopt and update a LCAP. The LCAP must include locally-determined goals, actions, services, and expenditures of LCFF funds for each school year in support of the state educational priorities that are specified in statute, as well as any additional local priorities. In adopting the LCAP, LEAs must consult with parents, students, teachers, and other school employees.

The eight state priorities that must be addressed in the LCAP, for all students and significant student subgroups in a school district and at each school, are:

- *Williams* settlement issues (adequacy of credentialed teachers, instructional materials, and school facilities).
- Implementation of academic content standards.
- Parental involvement.
- Pupil achievement (in part measured by statewide assessments, Academic Performance Index, and progress of English-language learners toward English proficiency).
- Pupil engagement (as measured by attendance, graduation, and dropout data).
- School climate (in part measured by suspension and expulsion rates).
- The extent to which students have access to a broad course of study.
- Pupil outcomes for non-state-assessed courses of study.

County offices of education must also address the following two priorities:

- Coordination of services for foster youth.
- Coordination of education for expelled students.

LEAs must use the LCAP template that is adopted by the SBE. The board adopted an initial LCAP template through emergency regulations in January of 2014, and LEAs used this template to complete LCAPs for the 2014-15 year. The SBE revised the template, to increase transparency and ease of use, in regulations in November of 2014, and this new template will be used for the 2015-16 year. The new template also includes a detailed annual update section for LEAs to compare their planned actions, services, and expenditures in the past LCAP year with estimated actuals and review progress towards and applicability of goals.
School district LCAPs are subject to review and approval by county offices of education, while county office of education LCAPs are subject to review and approval by the State Superintendent of Public Instruction (SPI). The first year of LCAP review contained mixed results; there was praise for increased collaboration and outreach with school communities, but also criticism that many LCAPs did not meet all of the statutory and regulatory requirements. The SBE and SPI have begun efforts to increase the quality of LCAPs, specifically through the revised template, additional outreach and training, and working with county offices of education. Statute also established a process for districts to receive technical assistance related to their LCAPs. The SPI is authorized to intervene in a struggling district, under certain conditions. The SBE is required to adopt evaluation rubrics by October of 2015, for the state educational priorities that will assist LEAs and the SPI to assess district and school performance under the LCAPs and to identify where assistance and intervention are warranted. The SBE is currently working with stakeholders to develop the evaluation rubrics and initial drafts are anticipated to be released in spring of 2014.

GOVERNOR’S PROPOSAL

The Governor’s budget provides an increase of $4 billion in Proposition 98 funding for schools for the third year of LCFF implementation. This is the largest K-12 funding proposal out of the increased funds for Proposition 98. According to the LAO, this represents an 11 percent year-over-year increase for the LCFF. The DOF indicates this funding level represents closing approximately 32 percent of the gap between the school districts’ 2014-15 funding levels and the LCFF full implementation target rates as of the budget year.

According to the LAO, the proposed augmentation represents a nine percent increase in LCFF per-pupil funding from 2014-15. Under the Governor’s budget, the LCFF would be 85 percent funded in 2015-16. County offices of education, which reached full implementation in 2014-15, would receive a cost-of-living increase. The DOF still anticipates an eight-year phase-in for funding of school district and charter school LCFF target rates, but the budget proposal reflects an acceleration of LCFF funding for districts and charter schools over the next few years that would later taper down. The DOF estimates that county offices of education would be brought very close to their target rates in the budget year.

ISSUES TO CONSIDER

LCFF Funding Acceleration. The budget proposes to pay down approximately 32 percent of the remaining gap between 2014-15 funding levels and target funding at full LCFF implementation. When the LCFF was enacted, it was anticipated that full implementation would take eight years. The budget still assumes an eight-year timeline, but it accelerates LCFF funding over the next few years and funding winds down in later years. Is this the appropriate funding level and timing for full implementation? Should the state continue to devote considerable Proposition 98 resources to accelerate implementation of LCFF in the early years? What investments have LEAs made with LCFF resources in the initial years of implementation?
LCAP Implementation. LEAs completed LCAPs for the first time for the 2014-15 fiscal year. The document is intended to detail an LEA’s goals in the state priority areas and describe how an LEA will achieve the goals through actions, services, and expenditures. In addition, the LCAP is where an LEA must provide information about how supplemental and concentration funds are expended and how an LEA is meeting the proportionality requirement to increase or improve services for educationally-disadvantaged students. The Legislature may wish to continue to provide oversight as to how LCAPs are serving to further transparency for communities and what changes are being made to learn from, and improve, upon LEAs experience in the first LCAP year.

California Collaborative for Educational Excellence. The California Collaborative for Educational Excellence (CCEE) was created as part of the new LCFF accountability framework with the role to advise and assist school districts, charter schools, and county offices of education to achieve goals in their local plans and petitions under the LCFF. The 2013-14 budget provided $10 million in Proposition 98 funding for the CCEE, and the 2014 education budget trailer bill (SB 858 [Committee on Budget and Fiscal Review], Chapter 32, Statutes of 2014) extended the encumbrance date for these funds through the 2014-15 fiscal year. According to the SBE and SPI, a contract for a fiscal agent is in place, the funds are fully encumbered and the first meeting of the CCEE will take place in February of 2015. The Legislature may want to examine the status of the CCEE to determine when technical assistance will be available for LEAs and what the future funding needs of the CCEE will be.
Proposed Expenditures of Increased Proposition 98 Resources

BACKGROUND

California provides academic instruction and support services to over six million public school students in kindergarten through twelfth grade (K-12) and 2.3 million students in community colleges. There are 58 county offices of education, approximately 1,000 local K-12 school districts, more than 10,000 K-12 schools, and roughly 1,100 charter schools throughout the state, as well as 72 community college districts, 112 community college campuses, and 70 educational centers. Proposition 98, which was passed by voters as an amendment to the state Constitution in 1988, and revised in 1990 by Proposition 111, was designed to guarantee a minimum level of funding for public schools and community colleges.

The Governor’s proposed 2015-16 budget includes funding at the Proposition 98 minimum guarantee level of $65.7 billion. The budget proposal also revises the 2014-15 Proposition 98 minimum guarantee to $63.2 billion, an increase of $2.3 billion from the 2014 Budget Act, and revises the 2013-14 Proposition 98 minimum guarantee to $58.7 billion, an increase of $371 million from the 2014 budget act. The Governor also proposes to pay $250 million in Proposition 98 settle-up towards meeting the 2006-07 and 2009-10 Proposition 98 minimum guarantees. Together, the increased guarantee levels and settle-up payments reflect a total of $7.8 billion in increased funding for education over the three years as compared to the 2014 Budget Act.

The Governor proposes to use one-time Proposition 98 funds to pay off the remaining K-14 education deferrals and reduce the mandate backlog. Most of the ongoing Proposition 98 increase is proposed to be used towards implementing the Local Control Funding Formula (LCFF). The Governor’s proposal also includes several other initiatives in the areas of adult education, career technical education, and facilities among others. These proposals are more fully described below.

Proposition 98 Funding. State funding for K-14 education—primarily K-12 local educational agencies and community colleges—is governed largely by Proposition 98. The measure, as modified by Proposition 111, establishes minimum funding requirements (referred to as the “minimum guarantee”) for K-14 education. General Fund resources, consisting largely of personal income taxes, sales and use taxes, and corporation taxes, are combined with the schools’ share of local property tax revenues to fund the Proposition 98 minimum guarantee. These funds typically represent about 80 percent of statewide funds that K-12 schools receive. The largest contributors to non-Proposition 98 education funds consist of revenues from local parcel taxes, other local taxes and fees, federal funds and proceeds from the state lottery.

The table below summarizes overall Proposition 98 funding for K-12 schools and community colleges since 2007-08, or just prior to the beginning of the steep recent recession. 2012-13 marked a turning point for education funding, and resources have grown each year since then.
The economic recession impacted both General Fund resources and property taxes. The amount of property taxes has been impacted by a large policy change in the past few years—the elimination of redevelopment agencies (RDAs) and the shift of property taxes formerly captured by the RDAs back to school districts. The guarantee was adjusted to account for these additional property taxes, so although LEAs received significantly increased property taxes starting in 2012-13, they received a roughly corresponding reduction General Fund.

### Proposition 98 Funding

**Sources and Distributions**

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>42,015</td>
<td>34,212</td>
<td>37,044</td>
<td>35,508</td>
<td>33,136</td>
<td>41,682</td>
<td>42,824</td>
<td>46,648</td>
<td>47,019</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>14,563</td>
<td>15,001</td>
<td>14,624</td>
<td>14,139</td>
<td>14,132</td>
<td>16,224</td>
<td>15,849</td>
<td>16,505</td>
<td>18,697</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>56,577</strong></td>
<td><strong>49,213</strong></td>
<td><strong>51,667</strong></td>
<td><strong>49,647</strong></td>
<td><strong>47,268</strong></td>
<td><strong>57,907</strong></td>
<td><strong>58,673</strong></td>
<td><strong>63,153</strong></td>
<td><strong>65,716</strong></td>
</tr>
</tbody>
</table>

**Distribution**

| K-12    | 50,344 | 43,162 | 45,695 | 43,710 | 41,901 | 51,719 | 52,182 | 56,171 | 58,005 |
| CCC     | 6,112  | 5,947  | 5,879  | 5,850  | 5,285  | 6,110  | 6,413  | 6,902  | 7,630  |
| Other   | 121    | 105    | 93     | 87     | 83     | 78     | 78     | 80     | 80     |

Source: Legislative Analyst’s Office

Calculating the Minimum Guarantee. The Proposition 98 minimum guarantee is determined by comparing the results of three “tests”, or formulas, that are based on specific economic and fiscal data. The factors considered in these tests include growth in personal income of state residents, growth in General Fund revenues, changes in student average daily attendance, and a calculated share of the General Fund. When Proposition 98 was first enacted by the voters in 1988, there were two “tests”, or formulas, to determine the required funding level. Test 1 guaranteed a percentage of General Fund revenues based on the pre-Proposition 98 level of General Fund that was provided to education, plus local property taxes. Test 2 guaranteed the prior year funding level adjusted for growth in student average daily attendance and per capita personal income. K-14 education was guaranteed funding at the higher of these two tests. In 1990, Proposition 111 added a third test, Test 3 which takes the prior year funding level and adjusts it for growth in student average daily attendance and per capita General Fund revenues. The Proposition 98 formula was adjusted to compare Test 2 and Test 3, the lower of which is applicable. This applicable test is then compared to Test 1 and the higher of the tests determines the Proposition 98 guarantee level.
Proposition 98 Tests
Calculating the Level of Education Funding

<table>
<thead>
<tr>
<th>Test</th>
<th>Calculated Level</th>
<th>Operative Year</th>
<th>Times Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Test 1</td>
<td>Based on a calculated percent of General Fund revenues (currently around 38.4%).</td>
<td>If it would provide more funding than Test 2 or 3 (whichever is applicable).</td>
<td>4</td>
</tr>
<tr>
<td>Test 2</td>
<td>Based on prior year funding, adjusted for changes in per capita personal income and attendance.</td>
<td>If growth in personal income is ≤ growth in General Fund revenues plus 0.5%.</td>
<td>14</td>
</tr>
<tr>
<td>Test 3</td>
<td>Based on prior year funding, adjusted for changes in General Fund revenues plus 0.5% and attendance.</td>
<td>If statewide personal income growth &gt; growth in General Fund revenues plus 0.5%.</td>
<td>8</td>
</tr>
</tbody>
</table>

Generally, Test 2 is operative during years when the General Fund is growing quickly and Test 3 is operative when General Fund revenues fall or grow slowly. The Test 1 percentage is historically based, but is adjusted, or “rebenched”, to account for large policy changes that impact local property taxes for education or changes to the mix of programs funded within Proposition 98. In the past few years, rebenching was done to account for property tax changes, such as the dissolution of the RDAs, and program changes, such as removing childcare from the Proposition 98 minimum guarantee and adding mental health services. In the budget year, the Test 1 calculation is adjusted to reflect the end of the “triple flip” and the retirement of the Economic Recovery Bonds and for RDA changes. Proposition 98 tests are based on estimated factors during budget planning, however the factors are updated over time and can change past guarantee amounts and even which test is applicable in a previous year. Statute specifies that at a certain point the Proposition 98 minimum guarantee for a given year shall be certified and no further changes shall be made.

The Governor’s proposal assumes that in 2015-16, the Proposition 98 guarantee is calculated under Test 2, the current year is a Test 1 year, and prior year is a Test 3. A Test 2 is reflective of the increased General Fund revenues the state is receiving during this economic recovery period. Generally, the Proposition 98 minimum guarantee calculation was designed in order to provide growth in education funding equivalent to growth in the overall economy, as reflected by changes in personal income (incorporated in Test 2). As noted in the table above, in most years the Proposition 98 minimum guarantee has been determined by the application of Test 2.

Suspension of Minimum Guarantee. Proposition 98 includes a provision that allows the Legislature and Governor to suspend the minimum funding requirements and instead provide an alternative level of funding. Such a suspension requires a two-thirds vote of the Legislature and the concurrence of the Governor. To date, the Legislature and Governor have suspended the Proposition 98 minimum guarantee twice—in 2004-05 and 2010-11. While the suspension of Proposition 98 can create General Fund savings during the year in which it is invoked, it also creates obligations in the out-years, as explained below.
Maintenance Factor. In years following suspension of the Proposition 98 minimum guarantee or the operation of Test 1 or Test 3 (that is, when the Proposition 98 guarantee grows more slowly due to declining or low General Fund growth), the state creates an out-year obligation referred to as the “maintenance factor.” When growth in per capita General Fund revenues is higher than growth in per capita personal income (as determined by a specific formula also set forth in the Constitution), the state is required to make maintenance factor payments, which accelerate growth in K-14 funding, until the determined maintenance factor obligation is fully restored. Outstanding maintenance factor balances are adjusted each year by growth in student average daily attendance and per capita personal income.

The maintenance factor payment is added on to the minimum guarantee calculation using either Test 1 or Test 2.

- In a Test 2 year, the rule of thumb is that roughly 55 percent of additional revenues would be devoted to Proposition 98 to pay off the maintenance factor.

- In a Test 1 year, the amount of additional revenues going to Proposition 98 could approach 100 percent or more. This can occur because the required payment would be a combination of the 55 percent (or more) of new revenues plus the established percentage of the General fund—roughly 38.4 percent—that is used to determine the minimum guarantee.

Prior to 2012-13, the payment of maintenance factor was made only on top of Test 2, however in 2012-13, the Proposition 98 guarantee was in an unusual situation as the state recovered from the recession, it was a Test 1 year and per capita General Fund revenues were growing significantly faster than per capita personal income. Based on a strict reading of the constitution, the payment of maintenance factor is not linked to a specific test, but instead is required whenever growth in per capita General Fund revenues is higher than growth in per capita personal income. As a result the state funded a maintenance factor payment on top of Test 1 and this interpretation continues today and results in the potential for up to 100 percent or more of new revenues going to Proposition 98 in a Test 1 year with high per capita General Fund growth, as is the case in 2014-15.

The Governor’s proposal includes maintenance factor payments of $3.8 billion in the 2014-15 year and $725 million in the 2015-16 year, leaving a balance of approximately $1.9 billion going into the 2016-17 year.

Settle-Up. Every year, the Legislature and Governor estimate the Proposition 98 minimum guarantee before the final economic, fiscal, and attendance factors for the budget year are known. If the estimate included in the budget for a given year is ultimately lower than the final calculation of the minimum guarantee once those factors are known, Proposition 98 requires the state to make a "settle-up" payment, or series of payments, in order to meet the final guarantee for that year. The Governor’s budget assumes General Fund settle-up payments of $371 million in 2013-14 and $2.3 billion in 2014-15 (due to increases in the guarantees for those years.) The Governor’s budget proposal also includes a settle-up payment of $250 million with $211 million
going toward the 2006-07 minimum guarantee and the remaining $44 million counting towards the 2009-10 minimum guarantee.

**Spike Protection.** Proposition 98 also has a built-in formula to prevent large increases in the guarantee, referred to as “spike protection”. This constitutional formula specifies that in years when a Test 1 is operative and is greater than the Test 2 amount by 1.5 percent of General Fund Revenues, then when calculating the guarantee level in the subsequent year, the excess amount over the 1.5 percent of General Fund revenues is not included in the calculation. This part of the formula has only been in play once, impacting the 2013-14 minimum guarantee.

**Outstanding Obligations.** The state currently has outstanding obligations to school districts and community colleges. As of the 2014-15 budget act, outstanding obligations included close to $6 billion in mandate payments, $992 million in deferrals, and $273 million in Emergency Repair Program payments. The Governor’s proposal for 2015-16 would retire the remaining deferrals, the remaining Emergency Repair Program payments, and approximately $1.5 billion in mandate obligations. The state also has a $1.3 billion outstanding Proposition 98 settle-up obligation, which can be used to pay off these aforementioned obligations.

**GOVERNOR’S PROPOSAL**

**K-14 Proposition 98 Education Overall.** The Governor’s budget estimates that the total Proposition 98 guarantee (K-14) for 2013-14 increased by $371 million, compared to the level estimated in the 2014 Budget Act. Similarly, for 2014-15, the Governor estimates an increase in the total guarantee of $2.3 billion. Both of these adjustments lead to Proposition 98 “settle-up” obligations, which result in additional one-time resources. The Governor proposes to use these additional one-time resources primarily to pay off deferrals and reduce the backlog of mandate payments. The Governor’s budget estimates a total Proposition 98 funding level of $65.7 billion (K-14). This is a $4.9 billion increase over the 2014-15 Proposition 98 level provided in the 2014 Budget Act.

**K-12 Education Proposition 98 Major Spending Proposals.** The Governor’s budget includes a proposed Proposition 98 funding level of $57.3 billion for K-12 programs. This includes a year-to-year increase of more than $1.8 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2014-15. Under the Governor’s proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from $9,361 provided in 2014-15 to $9,667 in 2015-16. This 2014-15 proposed funding level in Proposition 98 funds for K-12 reflects a per-pupil increase of three percent, as compared to the revised per-pupil funding level provided for 2014-15. The Governor’s major K-12 spending proposals are identified below.

- **Local Control Funding Formula.** The 2013 Budget Act adopted the LCFF, a new way for the state to provide funding to school districts and county offices of education. The Governor’s budget proposes an increase of approximately $4 billion to implement the LCFF. This investment would eliminate about 32 percent of the remaining funding gap between the formula’s current year funding level and full implementation for school districts and charter schools. County offices of education reached full implementation
with the LCFF allocation in the 2014 Budget Act. Accountability for LCFF is also not yet fully implemented. Implementation of LCFF is more fully discussed in K-12 Finance & Accountability: Local Control Funding Formula in this report.

- **Paying off Deferrals.** The Governor’s budget proposes to pay off outstanding payment deferrals – a practice used in previous budgets whereby the state would delay the issuance of money to school districts for months after school districts had planned to spend it. The Governor’s budget proposes to end this practice by paying off all payment deferrals, estimated at a cost of $992 million for K-12 programs and community colleges. For K-12 programs, the Legislative Analyst’s Office (LAO) estimates the total amount of payment deferrals at $897 million, all of which would be paid off in the Governor’s proposed budget.

- **Adult Education.** The Governor’s budget proposes to provide $500 million in Proposition 98 funding for a new adult education block grant. In 2013-14 and 2014-15, K-12 districts had a maintenance-of-effort (MOE) requirement to continue to spend the same amount of funding on adult education as in 2012-13. In addition the 2013 Budget Act provided $25 million in two-year planning grants to community college and K-12 consortia for adult education. This Governor’s budget proposal is intended to build off of the last two years and fund adult education programs through regional consortia. The Chancellor of the Community Colleges and the Superintendent of Public Instruction would jointly approve the allocation of funds. In 2015-16, the funds would first be allocated to K-12 school districts in the amount of their MOE requirements in previous years and remaining funds would be allocated to regional consortia. In future years, all block grant funding would be allocated to regional consortia. Adult education consortia plans resulting from the 2-year planning grants included in the 2013 Budget Act will be provided by March 1, 2015. This proposal is part of the Administration’s overall workforce development plan and regional adult education efforts are intended to support occupations with high employment potential. The adult education proposal is more fully discussed in K-14 Workforce Initiatives: Adult Education and Career Technical Education in this report.

- **Enrollment and Cost-of-Living Adjustments.** The Governor’s proposed budget reflects an estimated decrease in student enrollment in the K-12 system. Specifically, it reflects an increase of $197.6 million in 2014-15, as a result of an increase in the projected average daily attendance (ADA), as compared to the 2014 Budget Act. For 2015-16, the Governor’s proposed budget reflects a decrease of $6.9 million to reflect a projected decline in ADA for the budget year. (For charter schools, the Governor’s proposed budget funds an estimated increase in charter school ADA—see “Other adjustments” below.) The proposed budget also provides $71.1 million to support a 1.58 percent cost-of-living adjustment for categorical programs that are not included in the new LCFF. These programs include special education and child nutrition, among others. The proposed funding level for the LCFF includes cost-of-living adjustments for school districts and county offices of education.
• **K-12 School Facilities.** The Governor’s budget proposes several changes to increase local and state capacity to fund facilities projects in the neediest schools and districts without providing additional funding resources.

  o Increase school districts’ ability to fund projects locally by raising the caps on assessed valuation and local bonded indebtedness, establishing consistency in developer fee levels, and expanding the use of restricted routine maintenance funds to include modernization and new construction.

  o Target state funding to the neediest school districts by limiting eligibility to schools districts that are unable to issue local bonds in amounts that meet student needs, providing priority for health, safety, and severe overcrowding projects, and establishing a sliding scale for determining the state share of funding based on local funding capacity.

  o Increase charter school access to the Charter School Facility Grant Program by reducing the eligibility threshold from 70 to 55 percent of enrollment of students eligible for free or reduced-price meals.

In addition, the Administration proposes to continue the dialogue with the Legislature and stakeholders that began in the current year about the best way to fund school facilities going forward, specifically focused on funding for the highest need schools and districts and increased local flexibility. Finally, the Governor’s budget proposes $273 million in one-time Proposition 98 funds for the Emergency Repair Program.

• **Proposition 98 Rainy Day Fund.** The Governor’s budget notes that with the passage of Proposition 2 in the November 4, 2014 general election, a deposit in a Proposition 98 Rainy Day Fund is required under certain circumstances. Related statute requires that in the year following a deposit into this fund, a cap on local school district reserves would be implemented. Although the Administration notes that is it unlikely that fiscal conditions triggering these actions would occur in the near future, they also note a willingness to engage with stakeholder groups who are concerned about the potential caps on school district reserves over the next few months.

Other K-12 Education Budget Proposals

Additional proposals contained within the Governor’s budget related to K-12 education include the following:

• **Career Technical Education.** The Governor’s budget proposes to provide $250 million in one-time Proposition 98 funding for each of the next three years for a Career Technical Education Incentive Grant Program. This program would provide funding for school districts, charter schools, and county offices of education to develop and expand career technical education programs. Grantees would be required to provide matching funds and demonstrate positive results on career technical education-related outcomes over time. Priority for funding would be given to regional partnerships. This marks a change from efforts to fund career technical education programs in prior years. Specifically, in 2013-
14 and 2014-15, K-12 districts had a maintenance-of-effort (MOE) requirement to continue to spend the same amount of funding on career technical education as in 2012-13. The 2013 and 2014 budget acts also provided $250 million each year in one-time Proposition 98 funding for the Career Pathways Trust Program to provide one-time competitive grants for career technical education programs. The career technical education proposal is more fully discussed in the section _K-14 Workforce Initiatives: Adult Education and Career Technical Education_ of this report.

- **Mandate Backlog Reduction.** The Governor’s budget proposes $1.1 billion in discretionary one-time Proposition 98 funding be provided to school districts, charter schools, and county offices of education to offset outstanding mandate debt. The Administration indicates that this investment is intended to allow school districts, charter schools, and county offices of education to continue to invest in implementing state-adopted academic standards—Common Core state standards, English Language Development standards and the Next Generation Science standards, upgrade technology, and support new responsibilities under the LCFF.

- **Technology Infrastructure.** The Governor’s budget proposes $100 million in one-time Proposition 98 funding to support increase broadband infrastructure for schools that have limited internet capacity or are unable to administer the new state assessments online.

- **Proposition 39 Energy Efficiency Investments.** The Governor’s budget proposes to allocate $368 million in Proposition 39 energy funds available in 2015-16, as follows:
  - $320.1 million to K-12 school districts, for energy efficiency project grants.
  - $39.6 million to community college districts, for energy efficiency project grants.
  - $5.3 million to the California Conservation Corps, to provide technical assistance to school districts.
  - $3 million to the Workforce Investment Board, for continued implementation of job-training programs.

- **Charter Schools.** The Governor’s budget proposes an increase of $59.5 million in Proposition 98 funds to reflect an increase in charter school ADA.

- **Child Care and Development.** The Governor’s budget provides $2.5 billion total funds ($899 million federal funds; $657 million Proposition 98 GF; and $941 million non-Proposition 98 GF) for child care and early education programs. For more information, please see Early Care and Childhood Education section of this report.
ISSUES TO CONSIDER

Legislative Education Priorities. The LAO, in analyzing the Governor’s proposed budget, notes that General Fund revenues for 2015-16 may be higher than the Governor has estimated. Both the Department of Finance and the LAO will provide updated revenue estimates at the May Revision. In the meantime, the Legislature should consider potential uses of additional one-time and ongoing Proposition 98 funds. Such potential uses could be to make one-time investments in areas of need for schools, such as implementation of common core standards or teacher training. Ongoing funds may potentially be used for accelerating progress towards full implementation of the LCFF, adult education programs, and early education needs among other options. Without additional funding options, the Legislature could also choose to use Proposition 98 revenues differently than the Governor proposes.

School Facilities. School Facilities have historically been funded through a mix of statewide general obligations bonds, local bonds, developer fees, and other local fund sources. For the past few years the Governor has signaled an unwillingness to back additional state bonds to fund facilities under the existing programs. The last bond was approved in 2006 and no bond authority currently remains in the state’s core school facilities program. The Governor has raised a variety of issues with the current programs and provided some potential changes that are intended to allow school facilities funding to be more easily financed at the local level and to target state funds to the neediest schools. The Legislature may wish to consider the impact of these policies on local school districts. Also, a larger conversation about the facilities needs of the state, and whether the Governor’s proposals will meet these needs over the long-term, is warranted. The Governor has offered to continue to work with the Legislature on refining a vision for a new facilities program. The role and amount of Proposition 98 and non-Proposition 98 funding needed to support a future facilities program is critical to any discussion.

Other issues to consider related to adult education, career technical education, LCFF and child care and development are covered separately under the Subcommittee 1 section of this report.
Workforce Initiatives: 
Adult Education and Career Technical Education

BACKGROUND

In addition to more traditional secondary and postsecondary education, the state, through school districts and community colleges, has also historically provided education for students, including adults, to gain the basic knowledge and skills necessary to actively participate as citizens and to enter the workforce. Two of the largest areas for the provision of these services are adult education and career technical education. Both areas are primarily state-funded, but also supported with federal funds under federal workforce and education initiatives. Services and funding for both adult education and career technical education have been in flux for the past two years, as the state explores ways to improve both the provision of services and outcomes for students.

Adult Education Background. Adult education has been delivered by a variety of different providers in different areas of the state. These providers primarily include community colleges and adult schools operated by school districts, but other local providers such as libraries participate in some areas. The Legislative Analyst’s Office (LAO) estimates that there are approximately 281 adult schools and 112 community colleges that provide adult education. These numbers are estimates, since data collection for adult education lacks coordination and data is particularly weak from adult schools. Adult school offerings began declining after the introduction of categorical flexibility in 2008-09 (discussed below) and updated data on services provided has not been collected comprehensively since. Recent enrollment counts from the Cabinet report, required by AB 86 (Committee on Budget), Chapter 43, Statutes of 2013, estimate that close to 1.5 million students are being served by various adult education providers.

Historically, adult education has lacked a clear definition and core mission and covered everything from learning English to completing secondary education to personal enrichment. Adult schools operated by school districts generally provide more of the literacy, high school diploma, English as a second language, and citizenship-related instruction, while community colleges have focused more on remedial instruction to prepare a student for college-level coursework and vocational education. However this school district and community college divide in education offerings is not consistent across the state, and local regions split adult education offerings in a variety of ways.

Adult Education Funding. Prior to 2008-09, school districts operating adult schools received Proposition 98 funding based on average daily attendance (ADA) at a specified rate for services through a categorical block grant (approximately $635 million annually). However under the policy of categorical flexibility (enacted in 2008-09), school districts’ categorical funds, including those for adult education, were reduced but categorical dollars could be used for any purpose through 2014-15. This new flexibility was intended to help soften the significant cuts
made to education funding as a result of the recession. The Department of Finance (DOF) estimates that roughly $300 to $350 million Proposition 98 is spent on adult education by school districts. Commencing with the 2013-14 fiscal year, the state transitioned to funding K-12 education under a new Local Control Funding Formula (LCFF). This new formula eliminated most categorical programs, including adult education, and instead provided school districts with a grade span adjusted per ADA amount based on the number and type (low income, English learner and foster youth students generate additional funds) of K-12 students. In order to protect adult education programs as the state transitioned to LCFF, the Legislature and the Governor enacted a maintenance-of-effort requirement to ensure school districts continued to expend, from their LCFF allocation, the same amount of funds on adult education as they had in 2012-13 through the 2014-15 fiscal years. (See K-12 Education: Local Control Funding Formula.)

Community colleges receive funding for adult education through Proposition 98 apportionments and receive different rates per student, based on the type of course and whether it is credit or non-credit instruction. According to the LAO, in 2014-15, community colleges received $6.9 billion in Proposition 98 funding (both General Fund and property taxes) to serve 2.3 million students (1.1 million full-time equivalent students). Of this $5.8 billion in apportionments, $5.6 billion is for credit instruction (1.1 million full time equivalent students) and about $230 million is for non-credit instruction (70,000 full time equivalent students). The remainder includes categorical funding. The LAO estimates that 25 percent to 30 percent of credit instruction, and about half of non-credit instruction, is related to adult education, at a cost of up to approximately $1.8 billion.

While adult education is funded primarily through Proposition 98 resources that are allocated for adult schools and community colleges, as discussed above, there are other funds sources as well. Some providers also receive federal funds through the former Workforce Investment Act and the newly passed Workforce Innovation and Opportunity Act; in 2014-15 a total of $86 million supported providers, including 139 adult schools and 19 community colleges, according to the LAO. Finally, adult education providers have some authority to charge fees: community colleges can charge fees for credit instruction and adult schools can charge fees for English as a second language, citizenship, vocational courses and other instructional areas. Fee revenue according to the LAO, is in the low tens of millions for school districts and approximately $120 million for community colleges.

A New Vision for Adult Education. At the same time LCFF was enacted to change the funding structure of K-12 education, the 2013 Budget Act and accompanying legislation in AB 86 set up a new structure for adult education that included:

- $25 million in planning grants for regional consortia that consist of school districts and community colleges and could include other local providers of adult education services. These funds could be used to examine existing adult education services, determine regional needs, and create a program plan to address adult education needs.

- Reporting on the planning from the California Department of Education and the Community Colleges Chancellor’s Office, referred to as the AB 86 Cabinet, due to the Legislature and Governor in March of 2014, and again in March of 2015.
• Intent language to continue to develop common policies for adult education and to fund an adult education program based on the consortia plans, commencing in 2015-16.

The March 2014 report from the AB 86 Cabinet detailed the organizational structure for the consortia, the initial planning process and the participants; 70 consortia (281 school districts and 72 community college districts) formed and received planning grants. These include all community college districts and all school districts operating adult education programs.

The March 2015 Cabinet report will detail the following, as required under LCFF statutes and additional legislation enacted in SB 173 (Liu), Chapter 545, Statutes of 2014:

• Current adult education services in each consortia region and any gaps in service.

• Plans to create linkages between services.

• Strategies to accelerate student progress towards academic and career goals.

• Plans for collaboration on professional development for providers.

• Plans to leverage existing regional structures such as local workforce investment boards.

• Recommendations on creating common assessment and placement policies for adult education students at adult schools and community colleges, linked data systems, consistent fee policies, and a comprehensive accountability system.

Career Technical Education Background. The California Department of Education defines career technical education as a “...program of study that involves a multiyear sequence of courses that integrates core academic knowledge with technical and occupational knowledge to provide students with a pathway to postsecondary education and careers.” It further defines 15 industry fields for career technical education as noted in the table below:

<table>
<thead>
<tr>
<th>Industry Sectors</th>
<th>Health Science and Medical Technology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Health Science and Medical Technology</td>
</tr>
<tr>
<td>Arts, Media, and Entertainment</td>
<td>Hospitality, Tourism, and Recreation</td>
</tr>
<tr>
<td>Building Trades and Construction</td>
<td>Information Technology</td>
</tr>
<tr>
<td>Business and Finance</td>
<td>Manufacturing and Product Development</td>
</tr>
<tr>
<td>Child Development and Family Services</td>
<td>Marketing, Sales, and Services</td>
</tr>
<tr>
<td>Energy and Utilities</td>
<td>Public Services</td>
</tr>
<tr>
<td>Engineering and Design</td>
<td>Transportation</td>
</tr>
<tr>
<td>Fashion and Interior Design</td>
<td></td>
</tr>
</tbody>
</table>

Career technical education has been provided through a variety of programs in California:
Regional Occupational Centers and Programs (ROCPs). ROCPs provide services for high school students over 16 and some adult students. According to the California Department of Education, approximately 470,000 students enroll in ROCPs each year. Students may receive training at schools or regional centers. The provision of career technical education services by ROCPs varies across the state and services are provided under the following organizational structures: 1) county office of education operates an ROCP in which school districts participate, 2) school districts participate in a joint powers agreement that operates an ROCP, or 3) a single school district operates an ROCP. Funding for ROCPs historically was on a hourly attendance basis, but is now provided under the LCFF.

Prior to 2008-09, ROCPs received funding through a categorical block grant (approximately $384 million Proposition 98 annually). However, similar to adult education, under the policy of categorical flexibility, school districts could use ROCP funds for any purpose through 2014-15. Commencing with the 2013-14 fiscal year, the state transitioned to funding K-12 education under a new LCFF. This new formula eliminated most categorical programs including separate ROCP funding and instead provided school districts with a grade span adjusted per ADA amount based on the number and type (low income, English learner and foster youth students generate additional funds) of K-12 students. The high school grade span rate included an additional 2.6 percent increase over the base grant to represent the cost of career technical education in high schools; however, school districts are not required to spend this funding on career technical education. In order to protect career technical education programs as the state transitioned to LCFF, the Legislature and the Governor enacted a maintenance-of-effort requirement to ensure local educational agencies continued to expend, from their LCFF allocation, the same amount of funds on career technical education as they had in 2012-13 through the 2014-15 fiscal year. (See *K-12 Education: Local Control Funding Formula.*) According to the California Department of Education, prior to this new flexibility there were 75 ROCP programs in the state and approximately six have closed or are planning to close since categorical flexibility was enacted.

Other Career Technical Education Categorical Programs. Three additional high school career technical education categorical programs exist outside of LCFF. The Specialized Secondary Program provides seed funds for pilot programs in specialized fields and supports two high schools with special programs in math, science, and the arts. The Agricultural Career Technical Education Incentive Program provides funds to support non-salary expenses for agriculture education. Finally, the California Partnership Academies support smaller scale instruction cohorts in career-related fields. Combined these categorical programs receive approximately $39 million in Proposition 98 funds. The Governor proposed folding the Specialized Secondary Program and the Agricultural Career Technical Education Incentive Program into LCFF in 2014-15; however, the Legislature rejected the proposal and retained separate funding to support these programs which are particularly important in specific regions of the state.
• **Career Pathways Trust and Career Technical Education Pathways Initiative.** Two grant programs provide funding to support building collaboration between career technical education programs in LEAs, postsecondary education institutions and the business community. The Career Pathways Trust is a one-time competitive grant program that provided $250 million in one-time Proposition 98 funding (available for expenditure for the 2014-15 and 2015-16). An additional $48 million in Proposition 98 funding has been provided for the Career Technical Education Pathways Initiative through 2014-15.

Community colleges also provide career technical education through their course offerings funded by Proposition 98 apportionments. The LAO estimates community colleges spend approximately $1.5 billion in apportionment funds on career technical education. Community colleges also receive categorical funds to support career technical education efforts in nursing, apprenticeship and an economic development program.

**Federal Effort in Adult Education and Career Technical Education.** At the national level, the Workforce Innovation and Opportunity Act (WIOA) was signed into law in July of 2014 and supersedes previous federal workforce investment legislation. Under the WIOA, federal investments in employment, education, and training services for adults, youth, dislocated workers and individuals with disabilities are authorized. While the detailed regulations and requirements of the WIOA are still under development, the focus of the new WIOA is to build coordination between these programs at the federal and state level to better support workers and the economy.

Under the WIOA, states are now required to complete four year strategic state plans to detail how the state will achieve workforce goals. Some of the areas of focus include the use of evidence-based, data-driven practices, regional collaboration that includes service providers and employers, and increased pathways from systems of education and training to employment. These new state plans need to be completed by July 1, 2016. The Governor notes that the programs he proposes in adult education and career technical education are aligned with the new WIOA requirements.

**GOVERNOR’S PROPOSAL**

The Governor’s budget contains several proposals designed to enhance the workforce. The proposals integrate requirements of the federal WIOA and indicates intent to continuing work with the Labor and Workforce Development Agency and other entities to develop a Unified State Workforce Investment Plan over the next year. Specifically, the proposed budget includes approximately $1.2 billion in additional funding to support adult education and career technical education programs to improve access to, and the quality of, the state’s workforce. The proposals are as follows:

• **New Adult Education Block Grant.** The Governor’s budget proposes to provide $500 million in Proposition 98 funding on an ongoing basis for a new Adult Education Block Grant. This Governor’s budget proposal is intended to build off of the last two years of planning and fund adult education programs through regional consortia.
The Chancellor of the Community Colleges and the Superintendent of Public Instruction would jointly approve the allocation of funds with priority going to those areas of highest need. In 2015-16, the funds would first be allocated to K-12 school districts in the amount of their MOE requirements in previous years and remaining funds would be allocated to regional consortia. In future years, all block grant funding would be allocated to regional consortia. These regional consortia will form allocation committees consisting of seven members, representing: community colleges, K-12 school districts, other adult education providers, local workforce investment boards, county social services departments, correctional rehabilitation programs, and a public member. These allocation boards will determine the allocation of funds among providers for direct instruction, support services, and administration.

The Governor’s budget notes that the details of the proposal will be informed by the AB 86 Cabinet report, which will be available in March of 2015.

- **New Career Technical Education Competitive Grant Program.** The Governor’s budget proposes to provide $250 million in one-time Proposition 98 funding for each of the next three years for a career technical education incentive grant program. This program would provide funding for school districts, charter schools, and county offices of education to develop and expand career technical education programs. Grantees would be required to provide matching funds and demonstrate positive results on career technical education-related outcomes over time. Priority for funding would be given to regional partnerships.

- **Extends Career Technical Education Pathways Initiative for One Year.** The Governor’s budget proposes to extend the Career Technical Education Pathways Initiative Program for community colleges for an additional year by providing $48 million in 2014-15 funds.

**ISSUES TO CONSIDER**

**Adult Education Funding.** The Governor’s proposal builds on the planning work done over the past two years. The Legislature may wish to consider the AB 86 Cabinet report, to be released in March of 2015, to inform their discussion. Several outstanding questions around funding remain. In the initial year of the program, should school districts receive an amount equal to the MOE requirement as proposed or would an alternate distribution of funds allow school districts to better transition to a new adult education program? Is $500 million an appropriate amount of funding and will it meet adult education needs? Will the allocation boards ensure funding is provided evenly for all adult education needs in a region or will various needs be prioritized?

**Adult Education Program.** There are still many complex issues around the provision of adult education. The Legislature may wish to consider recommendations from the AB 86 Cabinet report to inform their discussion of potential solutions. Some key policy questions that remain are: how will data on services and outcomes be collected; what type of accountability does the
state need over a new program; how can programs be aligned to provide consistent skills assessment, course placements, and efficient pathways to help adult students meet their goals?

**Career Technical Education.** Under LCFF, school districts and county offices of education no longer receive separate career technical education categorical funds. Similar to other programs previously funded with categorical funding, school districts could choose to continue to support programs that met the needs of their students at funding levels they deemed appropriate locally. The intention is that school districts would retain their most successful programs and use the flexibility to amend, strengthen, or eliminate other programs, based on local needs. The Governor and Legislature agreed to an MOE requirement on career technical education programs for two years to ensure LEAs had time to transition. In addition, some school districts participated in county office of education programs or other regional programs and the MOE allows participants time to examine these program relationships in light of the new funding requirements. The new Career Technical Education Incentive Grant Program would allow school districts and county offices of education an additional three years to transition to funding of career technical education under LCFF. The Legislature may wish to consider this option and review the following questions to ensure high quality career technical education programs are not dismantled due to LCFF. Will the new program structure and timing appropriately incentivize local school districts to retain and improve current programs and create new innovative programs? Does this new program fit within the long-term vision for LCFF? Are the outcome-based requirements of the program realistic and aligned with accountability under LCFF?
Child Care and Development

BACKGROUND

Programs in the early care and education system have two key objectives: to provide quality programs that support child development and to support parental work participation. Subsidized child care is for families whose incomes are below 70 percent of the state median income; where parents are working or participating in an education or training program; and, children are under the age of 13.

Table 1: California’s Child Care and Development Programs

<table>
<thead>
<tr>
<th>Program</th>
<th>Description</th>
<th>2014 Budget Act Slots</th>
<th>Proposed Slots for 2015-16</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalWORKs (based on estimated caseload)</td>
<td>Provides cash aid and services to eligible families. Begins when a participant enters the CalWORKs program.</td>
<td>38,363</td>
<td>40,847</td>
<td>6%</td>
</tr>
<tr>
<td>Stage 1</td>
<td></td>
<td>51,956</td>
<td>46,968</td>
<td>-10%</td>
</tr>
<tr>
<td>Stage 2</td>
<td>When the county deems a family “stable.” Participation in Stage 1 and/or Stage 2 is limited to two years after an adult transitions off cash aid.</td>
<td>34,563</td>
<td>35,908</td>
<td>4%</td>
</tr>
<tr>
<td>Subtotals for CalWORKs child care</td>
<td></td>
<td>124,882</td>
<td>123,723</td>
<td>-1%</td>
</tr>
<tr>
<td>Non-CalWORKs (based on proposed number of slots to be funded)</td>
<td>State and federally funded care for low-income working families not affiliated with CalWORKs program. Serves children from birth to 12 years old.</td>
<td>51,287</td>
<td>53,323</td>
<td>4%</td>
</tr>
<tr>
<td>General Child Care</td>
<td>State and federally funded care for low-income working families not affiliated with CalWORKs program. Helps families arrange and make payment for services directly to child care provider, as selected by family.</td>
<td>26,554</td>
<td>27,146</td>
<td>2%</td>
</tr>
<tr>
<td>Migrant Child Care</td>
<td>Serves children of agricultural workers while parents work.</td>
<td>2,505</td>
<td>2,609</td>
<td>4%</td>
</tr>
<tr>
<td>Severely Handicapped Program</td>
<td>Provides supervision, therapy, and parental counseling for eligible children and young adults until 21 years old.</td>
<td>145</td>
<td>146</td>
<td>1%</td>
</tr>
<tr>
<td>State Preschool</td>
<td>Part-day and full-day care for 3 and 4-year old children from low-income families.</td>
<td>148,588</td>
<td>153,177</td>
<td>3%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>353,961</td>
<td>360,124</td>
<td>2%</td>
</tr>
</tbody>
</table>
The state subsidizes child care for several years, with Stage 1 care provided for families seeking employment; Stage 2 for families who have been deemed “stable” or are transitioning off of cash assistance; and Stage 3, for families who have been off cash assistance for at least two years. Families that formerly participated in CalWORKs are typically guaranteed subsidized child care services, as long as they continue to meet specified income requirements. However, only a portion of non-CalWORKs families receive subsidized child care, and waiting lists are common.

**Historical funding for child care and development (CCD) programs.** Since 2008, the state’s overall CCD funding has decreased by $745 million total funds, or 23 percent. Until the 2011-12 fiscal year, the majority of these programs were funded from within the Proposition 98 Guarantee for K-14 education. California also receives funding from the federal Child Care and Development Fund (CCDF), which is used to help families with incomes below 85 percent of the state median income level. Four percent of the federal block grant must be spent on improving the quality of childcare.\(^1\)

**Reimbursement rates.** All Title 5 programs (General Child Care, Migrant Child Care, and State Preschool) receive the same reimbursement rate (depending on the age of the child), no matter where in the state the program is located. Since 2007, the standard reimbursement rate (SRR) was $34.38 per child per day of enrollment, and increased to $36.67 following a five percent increase in last year’s budget. Over the past few years, some small and medium-sized providers have been absorbed by larger providers that have greater economies of scale. This is one indication that the SRR may not be sufficient for them to operate. Reimbursement rates for license-exempt care remains at sixty percent of the regional reimbursement rate established for family child care homes. Alternative Payment Agencies (APs), which issue vouchers to eligible families, are paid through the “administrative rate”, which provides them with 17.5 percent of total contract amounts. As the state cut the number of child care slots, APs issued fewer vouchers, which generated less funding for programs.

**Recent budget actions.** Last year’s budget and trailer bills\(^2\) enacted an early care and education package with the goal to increase slots over time until the program could serve all low-income four-year-olds in CSPP or transitional kindergarten, and all eligible working families with full-day/full-year services. The package included quality enhancements, restoration and expansion of preschool access, increased reimbursement rates, and increased slots; specifically:

- **Increase Regional Market Rate (RMR) and the Standard Reimbursement Rate (SRR).** The regional market rate is the maximum rate the state will pay to reimburse child care providers accepting vouchers. The Budget Act of 2014 allocated $19.1 million to increase the RMR to the 85th percentile of the 2009 survey, reduced by 10.11 percent. Language also increased the SRR by five percent, effective July 1, 2014.

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\(^1\) Some examples of quality improvement programs include support for Resource & Referral Agencies, support for the Local Child Care and Development Planning Councils, and training and professional development for child care providers.

\(^2\) SB 852 (Budget and Fiscal Review Committee), Chapter 25, Statutes of 2014; SB 858 (Budget and Fiscal Review Committee), Chapter 32, Statutes of 2014; SB 876 (Budget and Fiscal Review), Chapter 687, Statutes of 2014.
• **California State Preschool Program.** The Budget Act of 2014 established 4,000 additional full-day State Preschool slots for part of the year. In addition, the 2014 Budget repealed CSPP family fees.

• **Professional Development.** $15 million of the funding provided in SB 852 must be allocated to the Department of Education to fund professional development stipends for teachers, to be administered by local planning councils. Further, SB 852 established priorities for the use of those funds, including first priority for transitional kindergarten (TK) teachers and second priority for teachers in the California state preschool program. Language also provided a one-time allocation of $35 million for facility and improvement and professional development.

• **Ongoing Quality Improvement Grants.** The 2014 Budget also provided an ongoing $50 million to quality improvement grants.

For more specific descriptions about the 2014 Budget Act, please see the Senate Budget and Fiscal Review Committee’s Final Action Report.

**Value of early childhood education.** The period from birth through age five is a critical time for a child to develop physical, emotional, social, and cognitive skills. Early childhood interventions have demonstrated consistent positive effects for a child’s long-term health and well-being, including better health outcomes, higher cognitive skills, higher school attainment, and lower rates of delinquency and crime. Some academic literature finds that investing in quality early childhood education can produce future budget savings. For example, James Heckman, a University of Chicago Nobel Laureate economist, found that quality preschool investments generate seven to ten cents per year on every dollar invested.

**GOVERNOR’S PROPOSAL**

The Governor’s budget provides $2.5 billion total funds ($899 million federal funds; $657 million Proposition 98 General Fund; and $941 million non-Proposition 98 General Fund) for child care and early education programs. The budget reflects an overall increase in child care funding by $101 million, attributed to changes in the cost of care in the CalWORKs programs, increases to the Regional Market Rate (RMR), and the inclusion of statutory growth and a cost-of-living adjustment (COLA) for specified programs. The table below provides the allocation amounts by program.

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### Program Governor’s Budget (dollars in millions)

<table>
<thead>
<tr>
<th>Program</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CalWORKs Child Care</td>
<td></td>
</tr>
<tr>
<td>Stage 1</td>
<td>$362</td>
</tr>
<tr>
<td>Stage 2</td>
<td>$349</td>
</tr>
<tr>
<td>Stage 3</td>
<td>$264</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$974</strong></td>
</tr>
<tr>
<td>Non-CalWORKs Programs</td>
<td></td>
</tr>
<tr>
<td>General Child Care</td>
<td>$574</td>
</tr>
<tr>
<td>Alternative Payment</td>
<td>$190</td>
</tr>
<tr>
<td>Other</td>
<td>$30</td>
</tr>
<tr>
<td>State Preschool</td>
<td>$657</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$2,497</strong></td>
</tr>
</tbody>
</table>

In addition, the budget includes the following:

- **Full-year funding for 4,000 full-day State Preschool slots.** The budget includes $16 million in ongoing Proposition 98 to support a full year of additional full-day State Preschool slots and $9.2 million in Proposition 98 to provide COLA for some child care programs. Also, the budget maintains ongoing $50 million quality grants for State Preschool, which are allocated on a competitive basis to local education agencies.

- **Full-year Regional Market Rate increase.** The 2014 Budget Act provided $19.1 million to increase the RMR for the Alternative Payment Program and all three CalWORKs stages starting January 1, 2015. The new RMR sets the maximum reimbursement rate at the 85th percentile of the 2009 regional market survey reduced by 10.11 percent. The budget annualizes the increase in reimbursement rates and provides $27.7 million.

- **Growth and statutory COLA for the Alternative Payment, General Child Care, State Preschool, Migrant, and Handicapped Programs.** The Governor’s budget includes an increase of $9.2 million Proposition 98 General Fund and $12.3 non-Proposition 98 General Fund to resume the COLA, which was suspended for programs from 2008-09 through 2014-15. The Governor’s budget provides a 0.57 percent growth adjustment and a 1.58 percent COLA. For the Alternative Payment Program the COLA increase is applied to the program’s appropriation, but its use is unspecified (traditionally this increase has supported additional slots). Programs using the Standard Reimbursement Rate (General Child Care, State Preschool, Handicapped and some Migrant programs), are increased by the COLA.

- **Adjustments for CalWORKs Stage 2 and Stage 3.** The budget includes an overall year-to-year decrease of $11.6 million for Stage 2 due to a decrease in caseload (4,988 fewer slots). Stage 3 funding increases $38.6 million year-to-year due to increases in the
average cost of care (independent from the RMR increase) and a slightly higher caseload (1,345 additional slots).

- **$50 million for quality grants.** The Governor’s proposal maintains the ongoing $50 million quality grants for State Preschool, which are allocated on a competitive basis to local education agencies.

- **Federal Child Care and Development Funds.** The budget includes a decrease of $14.9 million federal funds to reflect a reduction in carryover funds.

### ISSUES TO CONSIDER

**Child Care and Development Block Grant.** On November 19, 2014, the President reauthorized the federal Child Care and Development Block Grant (CCDBG), which includes new requirements, such as annualizing licensing inspections; providing health and safety inspections for non-family license-exempt providers, allowing extended income eligibility; providing funding for child care quality activities; and, restructuring professional development for child care providers and staff. Although the state may have several years to implement these changes, some policies and practices must be in place by October 2015. For example, CDE’s State Plan for 2016-18 must be submitted to the Legislature for review by April 1, 2014 and implemented by October 2015. Pursuant to the reauthorization of CCDBG, the state must also document its level of compliance, and plans for compliance, with new federal requirements. There is question whether the federal block grant funds will be sufficient to meet new requirements and to maintain current service levels. The Legislature may wish to consider the timing of the various statutory changes that may need to occur to comply with the federal CCDBG, and whether some of those changes will impact families’ access to child care and early education.

**Updating Quality Measures.** Four percent of the Child Care and Development Block Grant must be spent on improving the quality of child care. Examples of uses for quality funds include technical assistance and training, Resource & Referral (R&R) services, and grants and loans to providers for start-up costs. In 2012-13, the state budgeted $72 million for 27 distinct projects including professional development, stipends for providers, and activities related to health and safety. The Legislature may wish to examine more closely how those quality measure funds are being used and identify if there are better ways to allocate the funding.

**Statewide “Stability” Standard for CalWORKs.** Before a family moves from CalWORKs Child Care Stage 1 to Stage 2, a county must determine the family to be in “stable” condition. However, there is no statewide definition of what constitutes “stable.” Because funding for these programs rely heavily on caseload projections and estimates, unpredictable shifts from Stage 1 to Stage 2 could undermine the ability for resources to be allocated accordingly. The Legislature

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6 Every three years, California must prepare and submit a plan detailing how Child Care and Development Fund funds will be allocated and expended.

7 Every three years, California must prepare and submit to the federal government a plan detailing how its CCDF funds are allocated and expended. [http://www.cde.ca.gov/sp/cd/re/stateplan.asp](http://www.cde.ca.gov/sp/cd/re/stateplan.asp)
may choose to define “stable” for purposes of determining eligibility for transfer from Stage 1 to Stage 2 of CalWORKs Child Care.

Centralized Eligibility List (CEL). When funding exceeds demand, families must contact contractors directly to request information about being placed on waiting lists. The statewide CEL consolidated waiting lists for subsidized child care programs. Functionally, the CEL organized and prioritized enrollment of eligible and needy children; it also demonstrated the need for subsidized child care and funding by county and statewide. Due to the budget deficit at the time, the Budget Act of 2011 (Senate Bill 87, Budget and Fiscal Review Committee, Chapter 33) eliminated funding for CEL. At the time of its elimination, around 240,000 children were waiting for a subsidized child care slot. Since then, some counties have maintained their own CEL with existing local funds, but it remains difficult to estimate the total number of eligible families and children waiting for subsidized child care. The Legislature may wish to consider if there is an updated mechanism that can evaluate access to child care and provide real-time changes in the availability of slots.
Investing in Community College Student Success

BACKGROUND

The California Community Colleges (CCCs) is the largest system of community college education in the United States, serving approximately 2.1 million students annually. The CCC system is made up of 112 colleges operated by 72 community college districts throughout the state. California’s two-year institutions provide primary programs of study and courses, in both credit and noncredit categories, which address its three primary areas of mission: education for university transfer, career technical education, and basic skills. The community colleges also offer a wide range of programs and courses to support economic development and specialized populations.

As outlined in the Master Plan for Higher Education in 1960, the community colleges were designated to have an open admission policy and bear the most extensive responsibility for lower-division, undergraduate instruction. The community college mission was further revised with the passage of Assembly Bill 1725 (Vasconcellos), Chapter 973, Statutes of 1988, which called for comprehensive reforms in every aspect of community college education and organization. SB 164 (Alquist), Chapter 1579, Statutes of 1969 established a support framework for students and created the Equal Opportunity Programs & Services (EOPS), to provide categorical funding and special services to help meet the needs of the diverse range of students in the CCCs. Most recently, SB 1440 (Padilla), Chapter 428, Statutes of 2010, and SB 440 (Padilla), Chapter 720, Statutes of 2013, sought to improve transfer rates, and the Student Success Act (described further below).

The Board of Governors of the CCCs was established in 1967 to provide statewide leadership to California's community colleges. The board has 17 members appointed by the Governor, subject to Senate confirmation. Twelve members are appointed to six-year terms and two student members, two faculty members, and one classified member are appointed to two-year terms. The objectives of the board are:

- To provide direction, coordination, planning, and leadership to California's community colleges.
- To promote quality education in community colleges.
- To improve district and campus programs through informational and technical services on a statewide basis, while recognizing the community-oriented aspect of California's network of 112 community colleges.
- To seek adequate financial support while ensuring the most prudent use of public funds.

The following table displays the budgeted expenditures and positions for the CCCs as proposed in the Governor’s budget. Of the amounts displayed in the table, $4.2 billion in 2013-14,
$4.6 billion in 2014-15, and $5 billion in 2015-16 are supported by Proposition 98 General Fund. In addition, $9.4 million in 2013-14, $11.8 million in 2014-15, and $11.2 million in 2015-16 are supported by non-Proposition 98 General Fund. The remainder of funding comes from local property tax revenue, tuition and fee revenue and various special and federal fund sources.

<table>
<thead>
<tr>
<th>Governor’s Budget - CCCs Budgeted Expenditures and Positions</th>
<th>Dollars in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013-14</td>
</tr>
<tr>
<td>Personal Services</td>
<td>$16</td>
</tr>
<tr>
<td>Operating Expenses and Equipment</td>
<td>$4</td>
</tr>
<tr>
<td>Local Assistance</td>
<td>$7,139</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>$7,159</td>
</tr>
<tr>
<td><strong>Positions</strong></td>
<td>141.6</td>
</tr>
</tbody>
</table>

**Student Success Task Force.** Through the mid- and late-2000s, a number of studies highlighted the relatively low success rates of CCC students. In January 2011, the CCC’s Board of Governors embarked on a 12-month strategic planning process to improve student success. Pursuant to Senate Bill 1143 (Liu), Chapter 409, Statutes of 2010, the Board of Governors created the Student Success Task Force. The 20-member Task Force was composed of a diverse group of community college leaders, faculty, students, researchers, staff, and external stakeholders. The task force worked to identify best practices that promote student success while ensuring that educational opportunity for historically underrepresented students would not just be maintained, but bolstered. The task force issued the following recommendations:

1. **Increase Student Readiness for College**
   - Collaborate with K-12 to jointly develop common standards for college and career readiness.

2. **Strengthen Support for Entering Students**
   - Develop and implement common centralized diagnostic assessments.
   - Require incoming students to participate in diagnostic assessment, orientation and the development of an educational plan.
   - Develop and use system-wide technology (such as education planning tools) to better guide students in educational processes.
   - Require students showing a lack of college readiness to participate in support resources.
   - Require students to declare a program of study early in their academic careers.

3. **Incentivize Successful Student Behaviors**
   - Adopt system-wide enrollment priorities.
• Require students receiving Board of Governors Fee Waivers to meet various conditions and requirements.

• Provide students the opportunity to consider attending full time.

• Require students to begin addressing basic skills deficiencies in their first year.

4. **Align Course Offerings to Meet Student Needs**
   • Give highest priority for courses advancing student academic progress.

5. **Improve the Education of Basic Skills Students**
   • Support the development of alternative basic skills curriculum.

   • Develop a comprehensive strategy for addressing basic skills education in California.

6. **Revitalize and Re-envision Professional Development**
   • Create a continuum of mandatory professional development opportunities.

   • Direct professional development resources toward improving basic skills instruction and support services.

7. **Enable Efficient Statewide Leadership and Increase Coordination Among Colleges**
   • Develop and support a strong community college system office.

   • Set local student success goals consistent with statewide goals.

   • Implement a student success scorecard.

   • Develop and support a longitudinal student record system.

8. **Align Resources With Student Success Recommendations**
   • Encourage categorical program streamlining and cooperation.

   • Invest in the new Student Support Initiative.

   • Encourage innovation and flexibility in the delivery of basic skills instruction.

9. **A Review of Outcomes-Based Funding**
According to the task force report, which was unanimously adopted by the Board of Governors in January 2012, the recommendations were aimed at improving educational outcomes and student achievement for students and increasing the state’s workforce preparedness. The report noted that while a number of disturbing statistics around student completion reflect the challenges faced by the students they serve, they also clearly demonstrate the need for the system to recommit to finding new and better ways to serve its students.

Shortly thereafter, SB 1456 (Lowenthal), Chapter 624, Statutes of 2013, also known as the Seymour-Campbell Student Success Act of 2012, contained statutory changes necessary for implementation of some of the recommendations of the Task Force and the 2013 budget included $50 million for community college student success efforts.

Additionally, budget trailer bill language, SB 860 (Committee on Budget), Chapter 34, Statutes of 2014, codified the regulatory requirement that each CCC district maintain a Student Equity Plan. In 1996, the Board of Governors adopted a policy to require colleges to adopt a student equity plan to help ensure that historically underrepresented students have equal opportunity for access, success and transfer at colleges. Colleges are required to develop plans to examine specific student populations, determine if they are achieving access, success and transfer rates at the same level as other students, and develop strategies for improving these results, as needed. These plans must include the following:

- Campus-based research as to the extent of student equity by gender and for students that are current or former foster youth, disabled, low-income, veterans, or in specific ethnic and racial categories.

- Goals for access to, and completion of, basic skills, career technical education and workforce training, and transfer courses for the overall student population and for each population group and a determination of what activities are most likely to effectively meet those goals.

- Measures for addressing disparities, including: a means of coordinating with, at a minimum, specific student equity-related categorical programs or campus-based programs.
  - Student Success for Basic Skills Students
  - Student Financial Aid Administration
  - Disabled Students
  - Special Services for CalWORKs Recipients
  - Extended Opportunity Programs and Services and Special Services (EOPS)
  - Fund for Student Success
  - Student Success and Support Program
  - Programs for foster youth
  - Programs for veterans

- Sources of funds for activities in the plan.
A schedule and process for evaluation.

An executive summary.

The Budget Act of 2014 provided an additional $170 million Proposition 98 General Fund in the Student Success and Support Program (SSSP) categorical above the 2013-14 levels, including $70 million to develop or update, and begin implementing, their student equity plan. While student equity plans have been established in regulation since 1996, this is the first time that dedicated state resources have been provided for those plans.

In order to implement activities and goals outlined in student equity plans, the Chancellor of the CCCs is to allocate the funds in a manner that ensures districts that serve greater population of students who are high-need receive greater resources to provide services. In addition, as a condition of receipt of the funds the districts are required to include in their student equity plan how they will coordinate existing student support services, as outlined above, in a manner to better serve their high-need student populations.

Additionally, there are many well-established categorical programs and campus-based programs, mentioned above, that address specific student populations by helping students stay in school, complete programs and become employed. These programs have had proven results, for example a 2012 study of EOPS students found that EOPS students had higher retention and completion rates compared to non-EOPS students of similar backgrounds. Despite proven success, many programs received significant funding cuts in recent years that have not been restored.

Finally, the Budget Act of 2014 also included $1.1 million non-Proposition 98 General Fund and nine positions for the Chancellor’s Office to develop leading indicators of student success and to monitor districts’ performance. In addition, the budget included $2.5 million Proposition 98 General Fund to provide local technical assistance to support implementation of effective practices across all districts, with a focus on underperforming districts.

**GOVERNOR’S PROPOSAL**

**Investing In Student Success.** The Governor’s budget proposes an increase of $200 million Proposition 98 General Fund to improve and expand student success programs and to strengthen efforts to assist underrepresented students. This includes: 1) $100 million to increase orientation, assessment, placement, counseling, and other education planning services and, 2) $100 million to close gaps in access and achievement in underrepresented student groups, as identified in local student equity plans.


**ISSUES TO CONSIDER**

**Legislative Oversight Need as Student Equity Plans are Developed and Implemented.** For years, the Legislature has expressed concern about the low completion rates of CCC students. In an effort to promote better results, the Legislature passed legislation to implement the Student Success Task Force key recommendations mentioned above. Since the passage of SB 1456, the BOG has adopted various regulations to implement the provisions of the statute, including: a new enrollment priority policy, adopting academic standards for students receiving fee waivers, requiring students to declare academic goals, and requiring periodic updates on the SSSP and a new funding allocation for SSSP. SB 1456 also required the LAO to analyze how the various statutory provisions have affected CCC students’ access and success, disaggregated by various demographic groups. Because the community colleges are still in the planning and initial implementation phases, such data is not yet available for the LAO to review.

Under SB 860, a college must adopt a student equity plan in order to receive SSSP funds. As mentioned above, since 1996, BOG regulations required each college to adopt a student equity plan, however this year the equity plans were codified and received state funds to support the plans for the first time. Colleges were required to submit a student equity plan on or before January 1, 2015, and while most colleges have submitted plans to the Chancellor’s Office, some did not meet the deadline. The Chancellor’s Office recognizes that some colleges faced challenges on obtaining board approval before the end of 2014 due to the winter holidays, and is in the process of following up with districts that have not submitted plans and will work with them on a case-by-case basis.

SB 860 requires that community college districts serving greater populations of students who are high-needs students or disadvantaged students receive greater resources to provide services to these students. Student equity funds are distributed based on six factors: annual full time equivalents (FTEs) (40 percent), Pell Grant Awards (25 percent), educational attainment within a residential zip code (10 percent), district participation rate (5 percent), poverty rate (18 percent) and unemployment rate (2 percent) of the district (all based on available MIS data and ESRI data using census estimates). Funds for the equity plans became available on July 1, 2014; however, plans were not due until January 1, 2015. In order to address this timing issue, the Chancellor’s Office gives colleges the authority to spend funds prior to plan completion for 2014-15, and required that all expenditures be reflected in the plan submitted for approval and in year-end expenditure reports. Colleges received their first payment in October, and to date about $41.2 million in total has been appropriated.

Although more than half of the funds earmarked to implement the activities and goals of student equity plans have been allocated, it is unclear how the funds are being used and whether or not they coordinate with SSSP and existing categoricals. According to the Chancellor’s Office, the requirement for colleges to coordinate with the other categoricals came after colleges began working on their equity plans. In order to address this issue, the Chancellor’s Office released a memo allowing colleges to submit equity plans based on the previous format, as long as it includes an outline of how the new requirements will be incorporated and addressed. Because the community colleges just submitted the plans in January, the Chancellor’s Office is still in the
review process and has not released an executive summary or review of the plans. Additionally, a report on the expenditure of the funds is not scheduled to be submitted to the Legislature until March 15, 2016. The Legislature may wish to consider requesting an update on Student Equity Plans and SSSP funds at a future hearing.

Other Categorial Programs
While there is substantial merit in investing in student success strategies, it is important to note that other categorical programs that target underrepresented or disadvantaged students experienced significant funding reductions during the recent economic downturn. While the CCCs have done a significant amount through the Student Success Taskforce to refocus existing resources on better servicing their student population, including students with disabilities and economically-disadvantaged students, there are additional supports, beyond those identified in the SSSP program that are important to overall success of these students. The Governor’s budget proposal makes no augmentation to these programs, and instead increases funds for student equity plans and matriculation programs as mentioned above.

While continuing to invest in Student Success Taskforce efforts is consistent with recent fiscal and policy priorities of the Legislature in regards to CCCs, the Governor’s proposal of an additional $200 million that would be allocated to colleges for these efforts is more than double the current funding level. Colleges are still in the planning and initial implementation phases of the student success act and student equity plans, and there is limited data on the impacts these policies have had on student completion rates. In considering the Administration’s proposal, the Legislature may wish to consider the following questions:

1. Given that legislation passed in 2012 requires student orientation, assessment and education planning by Fall 2015, is the Governor’s proposed increase of $200 million for student success programs in 2015-16 an appropriate amount to implement the new policies?

2. Have colleges been able to absorb the relatively large infusions of funding over the last two years, and would they be able to absorb an even greater amount for the same activities in 2015-16?

3. Given that there is limited data on how student equity funds are spent, are appropriate reporting and oversight measures in place?

4. What is the appropriate state funding level for existing categorical programs that address student equity and success?

5. What other avenues should the Legislature consider in supporting student success?
Investing in Higher Education

BACKGROUND

During the recent recession, the state was limited in its ability to invest in public higher education, and significantly cut state support to the universities. The universities responded by shifting more of the financial burden to the students through increased tuition. Most notably, between 2004 and 2013, tuition at the University of California (UC) and California State University (CSU) more than doubled. Rapid tuition increases led to growing concerns about the affordability of higher education. The December 2012 Public Policy Institute of California (PPIC) Statewide Survey found that 65 percent of Californians were concerned about the cost of college. However, as the economy recovered, this trend of divestment started to reverse. The passage of Proposition 30 and recent budget acts facilitated a renewed investment in public higher education. Despite this improved trend, a larger discussion of the long-term sustainability of the UC and CSU emerged. In the November 2014 UC Board of Regents meeting, the regents voted to increase tuition by five percent annually over the next five years, despite concern from the public and members of the Legislature.

Over the last decade, the Legislature has developed various proposals to create greater accountability for, and accessibility to, higher education. However, the Legislature has limited control in regards to the operations and governance of the UC and CSU. They are both governed by independent boards, and the UC has constitutional autonomy, thus the budget is a critical legislative tool for ensuring that statewide goals and outcomes are being appropriately addressed by the state’s universities.

Given that significant budget authority has been delegated to UC and CSU, the Legislature has historically relied on two primary budgetary control levers or “tools”—earmarks and enrollment targets — to ensure that state funds are spent in a manner consistent with the Legislature’s intent and that access is maintained. The use of these tools has also ensured a clear public record and transparency of key budget priorities.

- **Earmarks.** Historically, the annual budget act included a number of conditions on UC's and CSU's General Fund appropriations. These earmarks have varied over the years in keeping with the Legislature's and Governor's particular concerns at the time. Due to the Governor’s vetoes, earmarks for the UC and CSU were essentially eliminated from the budget acts of 2012, 2013 and 2014.

- **Enrollment Targets.** Historically UC’s and CSU’s budgets have been tied to a specified enrollment target. To the extent that the segments failed to meet those targets, state funding associated with the missing enrollment reverted to the General Fund. Since 2007-08, the state budget only twice included both enrollment targets and enrollment growth funding. This was largely due to difficult budget years in which the state reduced support for the universities, and
in turn provided the universities with increased flexibility in how to respond. Though the state began to recover its fiscal footing in 2013-14, the Administration’s 2013-14 and 2014-15 budget proposals did not provide enrollment targets or enrollment funding, and instead gave the UC and CSU greater flexibility in managing their resources to meet obligations, operate instructional programs most effectively, and avoid tuition and fee increases.

University of California
The 1960 Master Plan for Higher Education designates the UC as the primary state-supported academic agency for research. In addition, the UC is designated to serve students at all levels of higher education and is the public segment primarily responsible for awarding the doctorate and several professional degrees, including in medicine and law. Joint doctoral degrees may also be awarded with the CSU.

There are ten UC campuses: Berkeley, Davis, Irvine, Los Angeles, Merced, Riverside, San Diego, San Francisco, Santa Barbara, and Santa Cruz. Nine of these are general campuses and offer undergraduate, graduate, and professional education. The San Francisco campus is devoted exclusively to the health sciences. The UC operates five teaching hospitals in Los Angeles, San Francisco, Sacramento, San Diego, and Orange counties. The UC has more than 800 research centers, institutes, laboratories, and programs in all parts of the state. The UC also provides oversight of one United States Department of Energy laboratory and is in partnerships with private industry to manage two additional Department of Energy laboratories.

The UC is governed by the Regents which, under Article IX, Section 9 of the California Constitution, has "full powers of organization and governance," subject only to very specific areas of legislative control. The article states that "the university shall be entirely independent of all political and sectarian influence and kept free therefrom in the appointment of its Regents and in the administration of its affairs." The Board of Regents consists of 26 members, as defined in Article IX, Section 9, each of whom has a vote (in addition, two faculty members — the chair and vice chair of the Academic Council — sit on the board as non-voting members):

- 18 regents are appointed by the governor for 12-year terms.
- One is a student appointed by the Regents to a one-year term.
- Seven are ex officio members — the Governor, Lieutenant Governor, Speaker of the Assembly, Superintendent of Public Instruction, president and vice president of the Alumni Associations of UC and the UC president.

The Governor is officially the president of the Board of Regents; however, in practice the presiding officer of the Regents is the Chairman of the Board, elected by the board from among its members for a one-year term, beginning each July 1. The Regents also appoint its officers of general counsel; chief investment officer; secretary and chief of staff; and the chief compliance and audit officer.
The following table displays the budgeted expenditures and positions for the UC, as proposed in the Governor’s budget. Of the amounts displayed in the table, $2.8 billion in 2013-14, $2.9 billion in 2014-15, and $3.1 billion in 2015-16 are supported by the General Fund. The remainder of funding comes from tuition and fee revenue and various special and federal fund sources.

### University of California

**Budgeted Expenditures and Positions**

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Services</td>
<td>$10,384</td>
<td>$10,870</td>
<td>$11,348</td>
</tr>
<tr>
<td>Operating Expenses and Equipment</td>
<td>$15,817</td>
<td>$16,041</td>
<td>$16,223</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td><strong>$26,201</strong></td>
<td><strong>$26,911</strong></td>
<td><strong>$27,571</strong></td>
</tr>
<tr>
<td><strong>Positions</strong></td>
<td><strong>91,183</strong></td>
<td><strong>92,034</strong></td>
<td><strong>92,034</strong></td>
</tr>
</tbody>
</table>

### California State University

The CSU system is comprised of 23 campuses, consisting of 22 university campuses and the California Maritime Academy. The California State Colleges were brought together as a system by the Donahoe Higher Education Act of 1960. In 1972, the system became the California State University and Colleges; the name of the system was changed to the California State University in January 1982. The oldest campus, San Jose State University, was founded in 1857 and became the first institution of public higher education in California. The program goals of the CSU are to:

- Provide instruction in the liberal arts and sciences, the professions, applied fields that require more than two years of college education, and teacher education to undergraduate students and graduate students through the master's degree.

- Provide public services to the people of the state of California.

- Provide services to students enrolled in the University.

- Support the primary functions of instruction, research, public services, and student services in the University and to ensure legal obligations related to executive and business affairs are met.

- Prepare administrative leaders for California public elementary and secondary schools and community colleges with the knowledge and skills needed to be effective leaders by awarding the doctorate degree in education.
Prepare physical therapists to provide health care services by awarding the doctorate degree in physical therapy.

Prepare faculty to teach in postsecondary nursing programs and, in so doing, help address California's nursing shortage by awarding the doctorate degree in nursing practice.

The CSU Board of Trustees is responsible for the oversight of the system. The board adopts rules, regulations, and policies governing the CSU. The board has authority over curricular development, use of property, development of facilities, and fiscal and human resources management. The 25-member Board of Trustees meets six times per year. Board meetings allow for communication among the trustees, chancellor, campus presidents, executive committee members of the statewide Academic Senate, representatives of the California State Student Association, and officers of the statewide Alumni Council. The Trustees appoint the chancellor, who is the chief executive officer of the system, and the presidents, who are the chief executive officers of the respective campuses.

The following table displays the budgeted expenditures and positions for the CSU, as proposed in the Governor’s budget. Of the amounts displayed in the table, $2.4 billion in 2013-14, $2.8 billion in 2014-15, and $2.9 billion in 2015-16 are supported by the General Fund. The remainder of funding comes from tuition and fee revenue and various special and federal fund sources.

<table>
<thead>
<tr>
<th>California State University</th>
<th>Budgeted Expenditures and Positions (Dollars in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013-14</td>
</tr>
<tr>
<td>Personal Services</td>
<td>$3,731</td>
</tr>
<tr>
<td>Operating Expenses and Equipment</td>
<td>$4,616</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>$8,347</td>
</tr>
<tr>
<td>Positions</td>
<td>42,444</td>
</tr>
</tbody>
</table>

Current Reporting Requirements
Both segments have various reporting requirement instituted by the Legislature. Pursuant to AB 94 (Committee on Budget), Chapter 50, Statutes of 2013, the UC and CSU are required to report biennially to the Legislature and Department of Finance (DOF), beginning October 1, 2014, on the total costs of education, on both a system wide and a campus-by-campus basis, segregated by undergraduate instruction, graduate instruction, and research activities. Further, the costs must be reported by fund source, including: 1) state General Fund; 2) system wide tuition and fees; 3) nonresident tuition and fees and other student fees; and, 4) all other sources of income.
In addition to various reporting requirements, SB 195 (Liu), Chapter 367, Statutes of 2013, set three broad state goals for higher education: 1) improving student access and success; 2) better aligning degrees and credentials with the state’s economic, workforce, and civic needs; and, 3) ensuring the effective and efficient use of resources.

Finally, SB 852 (Committee on Budget), Chapter 25, Statutes of 2014, required the UC Regents and the CSU Board of Trustees to adopt three-year sustainability plans, by November 30, 2014, for fiscal years 2015-16, 2016-17, and 2017-18. Specifically, the sustainability plans must include:

- Projections of available resources (General Fund and tuition and fees) in each fiscal year, using assumptions provided by the DOF.

- Projections of expenditures in each fiscal year and descriptions of any changes necessary to ensure that expenditures in each of the fiscal years are not greater than the available resources.

- Projections of enrollment (resident and non-resident) for each academic year within the three-year period.

- The University’s goals for each of the performance measures, as specified in Education Code, for each academic year within the three-year period.

### GOVERNOR’S PROPOSAL

#### Multi-Year Funding Plan

The Governor’s proposed budget includes a General Fund increase—$116 million for the UC and $128 million for CSU—to support the Administration’s third installment of their four-year investment plan in higher education. This plan, initiated in 2013-14, assumes additional General Fund support for the UC, the CSU, CCCs, and Hastings College of the Law over a four year period.

Under the plan, the UC and CSU received five percent annual base funding increases in 2013-14 and 2014-15 and would receive a four percent in the subsequent two years. The continuation of the multi-year plan is contingent upon the UC not increasing current tuition and fee levels in 2015-16, not increasing nonresident enrollment in 2015-16 and taking action to constrain costs. For CSU the increase is contingent on maintaining current tuition and fee levels. The Governor further expects the UC Regents to form a committee, supported by staff of the UC office of the President and the Administration, to develop proposals to reduce costs, enhance undergraduate access, and improve time-to-degree and degree completion. Subsequent to the release of the budget, this committee was formed, with membership consisting of the Governor and the UC President.
Consistent with the last two budgets, the Governor’s 2015-16 budget proposal continues to express major concerns with enrollment-based budgeting and asserts that funding enrollment growth does not encourage postsecondary institutions to focus on affordability, student completion, and education quality.

**Innovation Awards for CSU.** The Governor’s budget provides for $25 million in onetime funds, to award CSU campuses that are implementing initiatives that lead to more timely degree completions. This differs from the current year awards, which will be granted to UC and CSU campuses which succeed in achieving a broader set of goals. Similar to this year’s awards, a committee comprised of appointees from the DOF, the governing boards of the segments, and the Legislature, would make decisions in a competitive process.

### ISSUES TO CONSIDER

**Discretionary Funding, Cost Reviews and Legislative Oversight.** As requested in the Governor’s budget, the UC Board of Regents recently established the select advisory committee on the cost structure of the UC. The committee is comprised of the Governor and the UC President. The committee will solicit advice from a broad range of experts, review data and develop proposals that allow the UC to deliver quality education at a lower cost and obviate the need for increased tuition or increasing out-of-state enrollment. While the Administration and UC have an active role in the committee, it is unclear what the role the Legislature will play. The Legislature may have different ideas regarding how to evaluate and address the UC’s cost drivers.

Additionally, under AB 94, UC and CSU were required to submit a report on the total costs of education, on both a system wide and a campus-by-campus basis, by October 1, 2014. As of the writing of this report, the CSU has complied with this reporting requirement, and UC has submitted a preliminary report. UC states that the disaggregation of educational expenditures requested in the AB 94 language is not supported by their data systems. These reports breakdown the costs for education based on different types of students, discipline and other factors that could provide the Legislature with a more nuanced budget decisions on addressing cost drivers mentioned above.

This past fall was the first time the UC and CSU were required to adopt three year sustainability plans. Both UC and CSU adopted sustainability plans based on the revenue assumptions provided by the Administration. While there is some value in knowing what the segments plans relative to the Governor’s proposed funding, this process reflects the Governor’s priorities and not necessarily the Legislature’s. Additionally, the timing of the sustainability plans creates a public budget negotiation before the Legislature has input, and, as a result, leaves the Legislature out of the negotiation process.
The Governor enumerates several higher education priorities in his budget summary (for example, reducing the cost of education and improving affordability and timely completion rates): however, his funding plan includes large unallocated increases tied only to maintaining flat tuition levels and maintaining the number out of state students. It does not include enrollment targets or other accountability benchmarks, which ensure that qualified students are able to enroll in UC and CSU as envisioned in the Master Plan. Additionally, the Administration has not been supportive of funding a new university eligibility study. As a result, the state has limited information on whether UC and CSU continue to meet Master Plan goals of student access. According to the LAO, linking funding with enrollment serves an important state purpose because it expresses the state’s priority for student access and connects funding with student-generated costs. Despite these benefits, the Governor continues to disregard the state’s longstanding enrollment practices for UC and CSU.

According to the LAO, the Administration’s approach diminishes the Legislature’s role in key policy decisions and allows the universities to pursue their own interests rather than the broader public interest. The LAO notes continued unallocated base increases at the UC and CSU dilute the role and authority of the Legislature in the budget process, and, as a result, the Legislature will have difficulty assessing whether augmentations are needed and ultimately whether any monies provided would be spent on the highest state priorities.

The State’s Long-Term Goals for Higher Education. Coming out of the recession, California’s universities face numerous critical issues that impact the state’s ability to meet educational and workforce demands. The Governor’s budget overview recognizes some of these issues by pointing out the high-cost structure of the UC and the low completion rates of the CSU. However, while the Governor notes that the Administration’s long-term plan moves away from funding higher education based on the traditional model of enrollment targets, as previously mentioned, his budget does not explicitly tie funding to performance or specific outcome measures other than the maintenance of current tuition and fee levels and current non-resident enrollment at the UC.

As the state continues to reinvest in higher education, the Legislature may wish to consider how these investments address current and long-term education needs. This is particularly critical in light of a report from PPIC regarding California’s workforce demands, which found that by 2025, California will face a shortfall of one million college graduates required to meet the state’s skilled workforce needs. In addition, while there may be merit in moving away from a funding model based on enrollment targets, the Legislature may wish to consider an eligibility study to assess how many eligible students are being denied admission to California’s universities based on a lack of space. The CSU reported that, in the fall of 2013, it denied admission to more than 26,000 eligible students due to lack of funding. A severe lack of university slots for eligible students could result in increased costs due to: redundant community college coursework, increased financial aid, and longer time to graduation. In addition, there are likely to be personal non-system costs, such as students discontinuing their education altogether.
Alternative Funding Plans. In response to concerns about the affordability of higher education, several legislative proposals and plans have developed. SB 15 (Block) establishes polices that promote access, affordability and completion for UC and CSU students. Specifically, the bill would eliminate the UC’s 5 percent tuition increase for students; ensure 5,000 more California students are able to attend the UC in 2015-16; establish a Completion Incentive Grant (CIG) provided to CSU Students to encourage more timely degree completion; create 10,500 more student slots at the CSU in 2015-16; repeal this year’s scheduled 11 percent cut to Cal Grants; and provide 7,500 additional Cal Grant Competitive Awards for students who are not graduating high school seniors or recent graduates. The proposal pays for this plan through three sources: (a) increasing non-resident tuition at UC; (b) repurposing the Middle Class Scholarship program; and (c) increasing General Fund investment.

Similarly, the Assembly has also unveiled a plan to reject fee hikes for students, cap the number of out-of-state-student, increase tuition for out of state students, increase the number of California students by 10,000 over five years, accelerate the Middle Class Scholarship, and increase General Fund Support for UC and CSU by $50 million each, among other proposals.

At the segment level, both UC and CSU adopted budget proposals for 2015-16 calling for increases in funding beyond the Administration’s proposed four percent increase. Specifically, the UC requests the state provide an additional $100 million above the Governor’s budget. Should the state not increase its support, UC proposes to require more resources from students through steep tuition increases or by replacing California students with non-resident students. As noted above, the UC Board of Regents recently voted for an annual 5 percent increase in tuition and student services fee for the next five years. Similarly, CSU proposes the state provide an additional $97.1 million above the Governor’s budget. CSU and UC both argue that more funding would allow them to increase enrollment and invest in programs to improve student outcomes.

The LAO has offered a different approach and has consistently recommended the state adopt a share-of-cost fee policy, where increased funding needs would be met by a proportional increases in student tuition, state general fund contributions and segment contributions. This policy would base tuition and fee charges at each of the public higher education segments on a share of educational costs. Though such a policy would depend on the state providing its share of funding, LAO believes it would be more likely than the Governor’s proposal to result in moderate, gradual, and predictable tuition increases over time, and as a result encourage them to monitor and scrutinize proposed cost increases. LAO believes that it would shed light on the overall cost and improve public dialogue regarding whether cost increases are appropriate and may reduce future volatility in fee levels.

While California is starting to reinvest in higher education, plans to increase tuition have heightened concerns about the affordability of a college education and the appropriate level of investment necessary to meet statewide priorities. In considering the
Administration’s proposals, the Legislature may wish to consider the following questions:

- What role should the Legislature play in setting statewide higher education policy?

- How does the Governor’s approach ensure that the additional funding will support the statewide priorities?

- Does the Governor’s proposal sufficiently engage the Legislature in this accountability and budget process?

- Does the Governor’s proposal sufficiently address the long-term sustainability of public higher education?

- How does the Governor’s approach incorporate the sustainability plans and cost of education reports in the budget process?

- What is the appropriate state funding level to allow for enrollment growth, efficient per-student costs and improved outcomes?

- Are the UC and CSU doing enough to contain cost increases in areas such as pension reform, operational efficiencies and administrative salaries?
Resources

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Water – Connecting State Funding to Local Communities.......................... 2-10
Environmental License Plate Fund................................................... 2-19

Transportation

Transportation .............................................................................. 2-27
High-Speed Rail ............................................................................ 2-34
Overview of the 2015-16 Budget Resources

Cap-and-Trade Funding

BACKGROUND

The goal of the state’s climate plan is to reduce greenhouse gas (GHG) emissions to 1990 levels by the end of this decade. The Cap-and-Trade program, a key element in this Administration’s plan to achieve these goals, sets a statewide limit on the sources of greenhouse gases and establishes a financial incentive for long-term investments in cleaner fuels and more efficient energy use. The Cap-and-Trade program places a “cap” on aggregate GHG emissions from entities responsible for roughly 85 percent of the state’s GHG emissions. To implement the Cap and Trade program, the Air Resources Board (ARB) allocates a certain number of carbon allowances equal to the cap. Each allowance equals one ton of carbon dioxide equivalent. The ARB provides some allowances for free, while making others available for purchase at auctions. Once the allowances have been allocated, entities can then “trade” (buy and sell on the open market), the allowances in order to obtain enough to cover their total emissions for a given period of time. As part of its program, the ARB will give free allowances to the state’s large industrial emitters, as well as the state’s electric utilities, in order to reduce the economic impact of the Cap and Trade program.

Subsequent to the passage of AB 32 (Núñez and Pavley), Chapter 488, Statutes of 2006, the Legislature passed several bills related to the reduction of GHGs. These bills have provided guidance to the Administration as it continues to develop expenditure plans for auction proceeds. In addition, the Administration has issued several executive orders that, though not law, have also provided input into the development of the expenditure plan.

Cap-and-Trade Expenditures
Select Statutory and Executive Guidance

<table>
<thead>
<tr>
<th>Statute</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Warming Solutions Act 2006</td>
<td>• Established the goal to reduce greenhouse gas emissions to 1990 levels by 2020.</td>
</tr>
<tr>
<td>AB 32 (Núñez/ Pavley) Chapter 488 Statutes of 2006</td>
<td></td>
</tr>
</tbody>
</table>
| SB 535 (de León) Chapter 830 Statutes of 2012 | • Requires 10 percent of cap and trade proceeds be invested within the most impacted and disadvantaged communities.  
• Requires 25 percent of auction proceeds to benefit impacted and disadvantaged communities. |
| AB 1532 (Pérez) Chapter 807 Statutes of 2012 | • Required the Administration to develop a three-year investment plan for auction proceeds. |
| SB 375 (Steinberg)                  | • Directs the Air Resources Board to set regional GHG reduction targets and guides sustainable community strategies. |
| SB 1018 (Committee on Budget)      | • Provides guidance for collection and allocation of auction funds.  
| Chapter 728 Statutes of 2008       | • Requires state agencies to provide up-front information on GHG emission reductions prior to expenditure for any proposed auction-revenue funded program. |
| Chapter 39 Statutes of 2012        | |

<table>
<thead>
<tr>
<th>Executive Order</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Order B-18-12 (2012)</td>
<td>• Requires state agencies to reduce GHG emissions by 10 percent by 2015 and 20 percent by 2020.</td>
</tr>
</tbody>
</table>
| Executive Order B-16-12 (2012) | • Establishes targets for zero-emission vehicles in the state.  
|                           | • Establishes a GHG emission reduction target of 80 percent less than 1990 levels in the transportation sector by 2050. |
Implementing Benefits to Disadvantaged Communities. All auction revenues are subject to the provisions of SB 535 (de Léon), Chapter 830, Statutes of 2012. As discussed previously, SB 535 requires 10 percent of cap-and-trade proceeds be invested within the most impacted and disadvantaged communities, and 25 percent of auction proceeds to benefit impacted and disadvantaged communities. The Secretary for Environmental Protection (Cal-EPA) and the Air Resources Board (ARB) are charged with overseeing the implementation of this chapter, including identification of disadvantaged communities and reporting on the implementation as funding is distributed.

SB 535 directs the Secretary for Cal-EPA to identify disadvantaged communities. Identification must be based on geographic, socioeconomic, public health, and environmental hazard criteria. The criteria may include, but are not limited to:

- Areas disproportionately affected by environmental pollution and other hazards that can lead to negative public health effects, exposure, or environmental degradation.

- Areas with concentrations of people that are low-income, high unemployment, low levels of homeownership, high rent burden, sensitive populations, or low levels of educational attainment.

The Cal-EPA developed a tool called CalEnviroScreen to identify disadvantaged communities for investment. Through the Office of Environmental Health Hazard Assessment (OEHHA), the tool was developed to assess areas that are disproportionately affected by multiple types of pollution and areas with vulnerable populations. Using this tool, the Cal-EPA provided guidance to state agencies administering all cap-and-trade auction revenues in order to meet the provisions of SB 535.

In November 2014, the ARB released its first SB 535 report and included estimated auction revenue appropriations expected to benefit disadvantaged communities. The table below shows the funding and allocations with their respective benefits to disadvantaged communities. As shown, the Administration is planning to invest at least 33 percent of funds in areas benefiting disadvantaged communities, mainly from low-emission vehicle rebates, incentives for low-emission vehicles, and grants for weatherization and solar installation. For funding specifically targeted to disadvantaged communities, the majority is from the weatherization program and a small amount from the urban forestry program at CalFIRE.
### 2014-15 Investment in Disadvantaged Communities
#### As of November 2014

<table>
<thead>
<tr>
<th>Department</th>
<th>Activity</th>
<th>2014-15 (in millions)</th>
<th>% Targed to DAC</th>
<th>Total Benefiting DAC</th>
<th>Total Located in DAC</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-Speed Rail Authority</td>
<td>Construction of the Phase 1 blended system for high-speed rail</td>
<td>$250</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Strategic Growth Council</td>
<td>Affordable housing and sustainable communities</td>
<td>130</td>
<td>50%</td>
<td>$65</td>
<td>n/a</td>
</tr>
<tr>
<td>Transportation Agency</td>
<td>Transit and intercity rail capital</td>
<td>25</td>
<td>25%</td>
<td>$6</td>
<td>n/a</td>
</tr>
<tr>
<td>State Transit Assistance</td>
<td>Low carbon transit operation</td>
<td>25</td>
<td>32%</td>
<td>$8</td>
<td>n/a</td>
</tr>
<tr>
<td>Air Resources Board</td>
<td>Low-emission vehicle rebates and incentives for low emission vehicles</td>
<td>200</td>
<td>50%</td>
<td>$100</td>
<td>n/a</td>
</tr>
<tr>
<td>Community Services and Development Department</td>
<td>Grants for weatherization and solar installation including the Low-Income Home Energy Assistance Program</td>
<td>75</td>
<td>100%</td>
<td>$75</td>
<td>$75</td>
</tr>
<tr>
<td>Department of Forestry and Fire Protection</td>
<td>Fire prevention and urban forestry</td>
<td>42</td>
<td>n/a</td>
<td>n/a</td>
<td>$10</td>
</tr>
<tr>
<td>Department of Fish and Wildlife</td>
<td>Wetlands restoration (state and local assistance)</td>
<td>25</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Department of Resources Recycling and Recovery</td>
<td>Waste diversion</td>
<td>25</td>
<td>10%</td>
<td>$3</td>
<td>n/a</td>
</tr>
<tr>
<td>Department of General Services</td>
<td>Energy efficiency upgrades in state buildings</td>
<td>20</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Department of Food and Agriculture</td>
<td>Reducing agricultural waste</td>
<td>15</td>
<td>n/a</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td></td>
<td><strong>$832</strong></td>
<td><strong>33%</strong></td>
<td><strong>$275</strong></td>
<td><strong>$85</strong></td>
</tr>
</tbody>
</table>

(n/a): As of the time of reporting (November 2014), this information is not available.
GOVERNOR’S PROPOSAL

Cap-and-Trade Expenditure Proposal. The Governor’s budget proposes to spend $1.0 billion from cap-and-trade auction revenue in 2015-16. For sixty percent of the funds allocated in 2015-16, the allocation amounts are ongoing based on percentage allocations established for specific activities in Senate Bill 862 (Committee on Budget and Fiscal Review), Chapter 36, Statutes of 2014. As shown in the table below, proposals range from reducing agricultural waste to rail modernization. The majority of funding is directed to state agencies for both direct state projects and local assistance grant programs.

According to the Legislative Analyst’s Office (LAO), the total amount of revenue that will be raised from future cap-and-trade auctions is subject to substantial uncertainty, based on several factors, such as the allowance sales price. If all the allowances that are estimated to be auctioned in 2015-16 sell for the minimum price set by the state (between $12 and $13), state revenue would exceed $2.3 billion. Based on the LAO preliminary analysis, it is likely that the state will sell most or all of the allowances offered for sale in 2015-16. Therefore, state auction revenue will likely be significantly higher than what is assumed in the budget. To the extent that revenues exceed the amount assumed in the budget, those programs that are continuously appropriated specified percentages (as shown below), would receive significantly more funding in 2015-16 than is identified in the Governor’s budget. The rest of the additional revenue would be available to be allocated by the Legislature in the budget or future years based on its priorities.

Summary of Expenditures
Governor’s Cap-and-Trade Expenditures
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Department</th>
<th>Activity</th>
<th>Percent in Law*</th>
<th>2014-15</th>
<th>2015-16 Proposed</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-Speed Rail Authority</td>
<td>Construction of the Phase 1 blended system for high-speed rail</td>
<td>25 %</td>
<td>$250</td>
<td>$250</td>
</tr>
<tr>
<td>Strategic Growth Council</td>
<td>Affordable housing and sustainable communities</td>
<td>20 %</td>
<td>130</td>
<td>200</td>
</tr>
<tr>
<td>Transportation Agency</td>
<td>Transit and intercity rail capital</td>
<td>10 %</td>
<td>25</td>
<td>100</td>
</tr>
<tr>
<td>State Transit Assistance</td>
<td>Low carbon transit operation</td>
<td>5 %</td>
<td>25</td>
<td>50</td>
</tr>
<tr>
<td>Air Resources Board</td>
<td>Low-emission vehicle rebates and incentives for low emission vehicles</td>
<td>n/a</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Community Services and Development Department</td>
<td>Grants for weatherization and solar installation including the Low-Income Home Energy Assistance Program</td>
<td>n/a</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>Department of Forestry and Fire</td>
<td>Fire prevention and urban forestry</td>
<td>n/a</td>
<td>42</td>
<td>42</td>
</tr>
</tbody>
</table>
Transportation and Sustainable Communities. The Governor proposes $600 million for transportation-related programs and projects.

- **High-Speed Rail Project (High-Speed Rail Authority).** The budget includes $250 million for the state high-speed rail project. Funding will support construction of the Phase 1 blended system which extends from the San Fernando Valley to Los Angeles Union Station, linking the upgraded Metrolink corridor to Anaheim and connecting to commuter and urban rail systems throughout the Los Angeles region. These improvements allow high-speed trains to travel the entire 520 miles between San Francisco, Los Angeles and Anaheim.

- **Affordable Housing and Sustainable Communities (Strategic Growth Council).** The budget proposes $200 million for grants and loans projects that reduce greenhouse gas emissions (GHGs) by creating more compact, infill development patterns, integrating affordable housing, encouraging active transportation and mass transit usage, and protecting agricultural land from sprawl development. Two prototype projects that have been identified to implement this strategy are transit oriented development (reduce vehicle miles traveled in areas with high-quality transit systems) and integrated connectivity projects (reduce vehicle miles traveled in areas that lack high-quality transit). Funds will be allocated on a competitive basis. Final program guidelines will be published in January 2015. The process to award projects involves submission of a concept proposal followed by a full application for projects SGC selects. Projects will be awarded funding in June 2015.

- **Transit and Intercity Rail Capital Program (Transportation Agency).** The budget proposes $100 million to fund capital improvements and operational investments that will modernize California’s transit systems and intercity, commuter, and urban rail systems to reduce emissions of greenhouse gases by reducing vehicle miles traveled in California. Draft guidelines were released in mid-December 2014. Final guidelines will be published and the call for projects is expected to occur in February 2015. Projects will be selected through a competitive process with projects being awarded funding in August 2015.
- **Low Carbon Transit Operations Program (State Transit Assistance).** The budget includes $50 million to provide operating and capital assistance to transit agencies. The State Controller’s Office (SCO) will allocate funding to public transit agencies that currently qualify for funding in the State Transit Assistance Program. The SCO distributes allocations as follows: 50 percent of regional entities based on population and 50 percent to transit agencies based on farebox revenue. Eligible expenditures include new or expanded bus or rail services, including operating expenses such as equipment acquisition, fueling, and maintenance.

- **Low Carbon Transportation (Air Resources Board).** The budget proposes $200 million to continue the existing clean transportation programs that provide incentives for sustainable freight technology, zero-emission cars, low-emission cars in disadvantaged communities, and clean trucks and bus programs. The previous year investments included: $116 for the Clean Vehicle Rebate Project, which offers rebates directly to consumers who purchase zero-emission, and near-zero-emission vehicles; $85 million for low carbon trucks and buses with a focus on freight, for advanced technology, heavy duty vehicle and equipment deployments and demonstrations in disadvantaged communities; and, $10 for continued funding of the Truck Loan Assistance Program, which helps smaller truck fleets that have difficulty obtaining loans to upgrade their trucks, and provides enhanced credit assurance so small fleets can access loans for trucks with clean diesel technologies.

**Energy Efficiency and Clean Energy Programs.** The Governor proposes $110 million for clean energy programs including:

- **Weatherization Upgrades and Local Energy Efficiency (Community Services and Development Department).** The budget proposes $75 million to continue to support the existing weatherization and solar programs through local service providers, combined with the federal Low-Income Home Energy Assistance Program (LIHEAP) and Weatherization Assistance Program. Services benefit disadvantaged communities through the installation of solar photovoltaic systems, solar water heating systems, and weatherization measures. The use of energy audit tools will determine the installation of cost-effective measures such as insulation, weather stripping and caulking, water heater blankets, fixing or replacing windows, refrigerator replacement, and other specific projects.

- **Green State Buildings (California Energy Commission).** The budget provides $20 million to support the expansion of energy efficiency financing programs to reduce GHGs and energy usage in state buildings. Funding is provided through the State Energy Conservation Assistance Account for purposes of tracking and providing loans that may be used by state agencies, including the University of California and California State University.

- **Emission Reductions through Agriculture (Department of Food and Agriculture [CDFA]).** The budget provides $15 million to support the development and implementation of three specific programs at CDFA: (1) dairy digester research and development program to facilitate the design and construction of dairy digester systems;
(2) nitrogen research and management program to fund research and technical assistance on reducing nitrous oxide emissions, nitrification inhibitors, water and nitrogen movement in the environment, and evaluation of water and nitrogen management practices; and, (3) an alternative and renewable fuels program to develop fuel quality specifications and standards for renewable and zero emission fuels, such as biofuels produced from dairy digesters and other agricultural waste.

**Natural Resources and Waste Diversion.** The Governor proposes $92 million for natural resources and waste programs including:

- **Wetland Restoration (Department of Fish and Wildlife).** The budget provides $25 million for wetland restoration. Projects include: (1) planning and implementation of Sacramento-San Joaquin Delta and coastal restoration projects that integrate GHG reduction, flood protection, habitat restoration, and climate change readiness; (2) planning and implementation of mountain meadows restoration in the Cascade and Sierra Nevada mountain ranges including groundwater storage, stream flow stability, water supply and habitat restoration; and, (3) planning and implementation of wetland restoration and water efficiency projects on state-owned and administered lands. These projects will provide the state a dedicated program for integrating wetland restoration for fish and wildlife with water supply improvement and carbon sequestration.

- **Forest Management and Fire Prevention (Department of Forestry and Fire Protection [CalFIRE]).** The budget provides $42 million per year to support existing and expanded programs at CalFIRE. These include: (1) urban and community forestry local assistance grants; (2) demonstration state forests and cooperative wildland research, mainly at state forest facilities; (3) fuel reduction through CalFIRE’s vegetation management program, which are designed to reduce wildland fire threat through a cost-sharing program with landowners that focuses on a combination of treatment types; (4) reforestation services under the authority of the state nurseries and reforestation studies statutory guidance; (5) funding for the forest legacy program to invest in forestlands to prevent future conversion to non-forest use; and, (6) continued implementation of the forest practice program and forest pest control programs.

- **Waste Reduction, Recycling, and Composting (CalRecycle).** The budget provides $25 million annually to support the expansion of existing recycling programs designed to reduce methane emissions at landfills and reduce further GHG in upstream management and manufacturing processes. The majority of funding will be used for grants and loans for in-state development of infrastructure to process organic materials and recyclable commodities into new value-added products.
ISSUES TO CONSIDER

Benefits to Disadvantaged Communities. Under state law, cap-and-trade expenditures must benefit disadvantaged communities. Some of these criteria are broad, across all expenditure categories, and others are program specific. Should the Legislature require each funding pot to adhere to SB 535 guidelines, including transportation and High-Speed Rail? What would be the impact directly to disadvantaged communities if more funding were allocated for direct benefit within these communities?

Allocation of 40 Percent Unallocated. A significant amount of funding (40 percent) is available to the Legislature annually for allocation. At present, funding is distributed mainly to the Governor’s priority areas including low-emission vehicle rebates and incentives, weatherization programs, and various natural resources programs. To achieve lower emissions as well as impact low-income areas and areas with greater impacts from climate change, the Legislature should consider options for this funding. For example, does the combination of waste diversion and energy efficiency upgrades in state buildings bring more benefits than, say, investment in clean and efficient drinking water systems? Would urban forestry programs make more of an impact in low-income and green-space poor areas? Should these programs, in particular, target a subset of need that has not yet been identified?

Revenues Underestimated? According to the LAO, revenues could exceed proposed budget expenditures by as much as 100 percent. To the extent revenues exceed the amount assumed in the budget, those programs that are continuously appropriated specified percentages of auction revenue would receive significantly more funding in 2015-16 than is identified in the Governor’s budget. The rest of the additional revenue would be available to be allocated by the Legislature in the budget or future years based on its priorities. Should the Legislature discuss alternative options to the Governor’s current program needs for additional funding? Are there areas that are underserved that might benefit from auction revenue proceeds?
Water—Connecting State Funding to Local Communities

BACKGROUND

Water Management in California

**State and Federal Responsibility for Water Management.** The state’s primary role in water management is to focus on water supply, water quality, and flood control. Many agencies are involved with water management at the state level. The primary two state agencies are the Department of Water Resources (DWR) and the State Water Resources Control Board (SWRCB). The DWR focuses on water delivery, water supply planning, and infrastructure development. The SWRCB is more of a regulatory body, managing water rights and water quality permitting (both of which have an impact on water supply). Most other state agency responsibilities center on specific mandates such as pesticide regulation, management of specific water resources, or public health.

Similar to the state, federal agencies also have distinct roles. The US Environmental Protection Agency (US EPA) focuses on water quality; the Bureau of Reclamation focuses on water supply; and the Army Corps of Engineers focuses on infrastructure and flood control. Both state and federal entities estimate and participate in California water supply planning, particularly as it relates to the Central Valley and the Sacramento-San Joaquin River Delta system (Delta).

**Local Responsibility for Water.** The majority of day-to-day water supply and water quality actions take place at the local level. Nearly all direct water supply is provided by a local purveyor, whether a special district or local jurisdiction (county/city). Similarly, water treatment (post-beneficial use) is a local responsibility. Sanitation districts provide local wastewater treatment, for example, while agricultural and major manufacturing may treat wastewater individually. In each case, permits are required by state and local agencies in order to comply with state and federal water quality rules.

According to the Public Policy Institute of California (PPIC), as seen in the following table, locals are responsible for about 84 percent of water spending in California. The state pays about 12 percent, and federal agencies contribute about four percent. This makes sense when one looks at how individuals pay for their water and wastewater needs. Local water and sanitation districts purchase water supply for a community and pay for the treatment of water after it has been used and local users are then billed monthly for the associated costs. The local agency may then be subject to a state permit for water for overall water quality.
Yearly Water-Related Spending in California by Source
2008-2011
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Local</th>
<th>State</th>
<th>Federal</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water supply</td>
<td>$14,777</td>
<td>$1,603</td>
<td>477</td>
<td>$16,857</td>
</tr>
<tr>
<td>Water pollution control</td>
<td>9,458</td>
<td>434</td>
<td>222</td>
<td>10,114</td>
</tr>
<tr>
<td>Flood management</td>
<td>1,324</td>
<td>574</td>
<td>254</td>
<td>2,152</td>
</tr>
<tr>
<td>Aquatic ecosystem management</td>
<td>25</td>
<td>405</td>
<td>241</td>
<td>671</td>
</tr>
<tr>
<td>Debt service on GO water bonds</td>
<td>0</td>
<td>689</td>
<td>0</td>
<td>689</td>
</tr>
<tr>
<td><strong>Total Spending</strong></td>
<td><strong>$25,584</strong></td>
<td><strong>$3,705</strong></td>
<td><strong>$1,194</strong></td>
<td><strong>$30,483</strong></td>
</tr>
</tbody>
</table>


Some communities work together to secure water supply or to pay for wastewater treatment. For example, the Metropolitan Water District (MWD) contracts water supply from the State Water Project, and Colorado River (among others), and acts as a wholesaler for most Southern California urban water. The MWD also develops and maintains water storage facilities within its jurisdiction.

According to the PPIC (Paying for Water in California, 2014), “water system development from statehood to the early 20th century was almost entirely locally funded, including flood works, irrigation canals, and large-scale storage and conveyance systems to bring water and hydroelectric power to growing urban areas in the Los Angeles and San Francisco Bay regions.” Various events in history have prompted state or federal funding of water projects, including the Great Depression (Central Valley Project) and the development of the State Water Project (SWP) in the 1960’s. However, in the particular case of the SWP, nearly 94 percent of the project was funded by local entities and this practice continues today.

**Bay Delta Conservation Plan—the State’s Latest Major Water Project.** The Sacramento-San Joaquin Delta (Delta) is a central part of the two major water delivery systems in the state—the SWP and the federally-managed Central Valley Project (CVP). From these two projects a majority of Californian’s derive all or part of their drinking water supply, and one-third of the state’s cropland receives water flowing from these projects. The state, after having spent two decades and $3 billion studying ways to help protect and restore the Delta, has embarked on a new water conveyance program, the Bay Delta Conservation Plan (BDCP). The BDCP is intended to help achieve co-equal goals by improving the Delta ecosystem and providing water supply reliability. Central to this is the development of tunnels and new conveyance to move water more efficiently through the Delta from north to south.
Over $176 million has been spent on planning activities related to the BDCP since 2006. Water contractors (those receiving water from the SWP and CVP), as well as state and federal agencies, have funded most of the BDCP to date. The BDCP estimates that the total cost of the BDCP, over a 50-year timeframe, is about $25 billion. Outside estimates have suggested this is under-forecast and put future costs upwards of $50 billion. It is unknown how much of these costs will be borne by locals or by the state. Annual investment in the Delta, for levee repairs, water supply, and flood control varies greatly depending on bond appropriations.

The Role of State Water Funding

State Water Policy, Direct Funding, and Water Bonds. Given that most direct water supply and management is executed by locals, what then is the ongoing role of state water funding? Beginning in 1952, the state’s role in water management has been to develop statewide water systems to move water from where it occurs (mainly in the north and eastern Sierra Nevada) to population centers and agricultural areas. Much of the rainfall occurs in the north of the state, while much of the demand is in the south. As a result, the SWP was designed in the 1950’s as a complex system for storing and transporting water through much of the state.

State Revolving Loan Funds—Response to Local Needs. In addition to water supply needs, various state and federal water laws have necessitated additional funding beyond what locals may have been capable of raising themselves in a reasonable timeframe. For example, the passage of the 1972 federal Clean Water Act was acknowledged as a groundbreaking law requiring water used for any purpose to be treated before being returned to rivers, streams and groundwater, in order for downstream or future users of the water to be able to access clean water. At the time, however, funding from state and federal agencies was needed to upgrade wastewater systems. The federal government established an ongoing funding stream (state wastewater revolving loan programs) that would provide funding to the states, for grants to locals, for wastewater system upgrades. This amount has varied substantially but currently is budgeted at about $137 million in 2015-16. Similar to this ongoing revolving loan fund, a drinking water loan fund was established to provide drinking water system upgrades.

Bond Funds—Water Funding for Local Projects. As shown in the figure following, separately from state and federal-initiated programs, since 1970, the state’s voters have authorized about $30 billion in water-related general obligation (GO) bonds, mainly for water quality and drinking water purposes. While some of these bonds have been used for land conservation and habitat protection, the vast majority of funds were for water management. In the 1970’s; bond funds were mainly for clean water and drinking water grants to locals. In the 1980’s; the voters began to approve bonds that included watershed preservation, specific land preservation (Lake Tahoe), and habitat enhancements. In nearly every bond, state agencies were given the management of the funds, but the majority of the dollars were delivered to locals through formulas or grant programs. Recent bonds have provided local assistance to the Integrated Regional Water Management (IRWM), focused on enhancing local control of projects.
Overview of the 2015-16 Budget Resources

History of Water Bonds
2001-2014
(Dollars in Billions)


Bond Funds for Flood Management. Starting in 2006, state bond funds approved by voters began to include flood control as a major purpose. The driving need for this funding was the deterioration of the state system of flood control, for which the state holds much of the liability should breaks or disaster occur. A local lawsuit (*Paterno v. State of California*, 1999) required the state to take responsibility for certain flood system upgrades, necessitating billions in state expenditures for projects. At the same time, local and federal projects (mainly through the Army Corps of Engineers) continued to require state matching funds, which have mainly been provided through bond funds. In November 2006, voters approved the Disaster Preparedness and Flood Prevention Bond Act of 2006 (Proposition 1E), providing $4.1 billion in generation obligation bonds for flood control projects and required that all funds be appropriated by July 1, 2016.

New Bond Approved in 2014. In November 2014, voters approved the Water Quality, Supply, and Infrastructure Improvement Act of 2014 (Proposition 1). This bond provides $7.5 billion in general obligation bond funds for projects that improve water supply, protect and restore watersheds, improve water quality, and increase flood protection. The majority of funds are designed to be allocated to existing state programs that provide grants and loans to local entities.

Emergency Measures and Drought Funding. The state also, from time to time, provides emergency funding for specific needs. In 2014, the Governor declared a drought emergency and the Legislature responded with early funding to immediately send money to state and local agencies for drought-related activities. These activities ranged from water supply projects to food assistance and work training for those impacted by the drought, mainly in agricultural areas. Over a two year period, the state provided over $838 million, mainly from the General Fund and bond funds, for various drought-related activities.
GOVERNOR’S PROPOSAL

The Governor’s budget provides three distinct water-related proposals described below.

**Proposition 1.** The Governor’s budget proposes $532.2 million from Proposition 1 bond funds in five main categories. As shown in the table below, allocations include $178 million for watershed protection and restoration; $137 million for water recycling, funding for local waste water and drinking water programs; $60 million for water supply reliability; and, $22 million for groundwater programs and projects. The proposal ties to the Governor’s Water Action Plan, an executive initiative released in 2014 that identifies actions the Administration plans to take over the next five years.

**Proposition 1E.** The Governor’s budget proposes $1.1 billion (mostly Proposition 1E bond funds), and numerous reappropriations, for DWR to support various, mostly ongoing, flood control activities. The majority of funds are proposed for capital outlay projects, and a smaller percentage is proposed for local assistance and state operations. The bond was written in a way to allow for flexibility in the appropriation process, so while these amounts are proposed by the Administration, the Legislature has some flexibility in its response to the proposals.

Additionally, because of bond requirements that all funding from Prop 1E be allocated before July 1, 2016, the Administration proposes to give DWR ten years to commit the funds to projects and an additional two years to expend the funds. A typical appropriation timeframe is three years for capital projects. The proposal would also to allow the department to shift funding between programs and projects without seeking approval from the Legislature. Perhaps most significantly, the Governor proposes to move this funding in advance of the normal budget process to accelerate flood funding.
Proposition 1
Governor’s Proposed Allocations
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Primary Focus</th>
<th>Department</th>
<th>2015-16 (Proposed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Watershed Protection and Restoration</td>
<td>Various (mainly state conservancies)</td>
<td>Wildlife</td>
<td>$178.0</td>
</tr>
<tr>
<td>Watershed restoration projects</td>
<td>State*</td>
<td></td>
<td>$139.1</td>
</tr>
<tr>
<td>Enhanced stream flow projects</td>
<td>Local</td>
<td>Conservation Board</td>
<td>$38.9</td>
</tr>
<tr>
<td>Water Recycling</td>
<td></td>
<td></td>
<td>$137.2</td>
</tr>
<tr>
<td>Water recycling projects</td>
<td>Local</td>
<td>SWRCB</td>
<td>$131.7</td>
</tr>
<tr>
<td>Water recycling and desalination</td>
<td>Local</td>
<td>Water Resources (DWR)</td>
<td>$5.5</td>
</tr>
<tr>
<td>Safe Drinking Water</td>
<td></td>
<td></td>
<td>$135.5</td>
</tr>
<tr>
<td>Drinking water treatment projects</td>
<td>Local</td>
<td>SWRCB</td>
<td>$69.2</td>
</tr>
<tr>
<td>Wastewater treatment projects</td>
<td>Local</td>
<td>SWRCB</td>
<td>$66.3</td>
</tr>
<tr>
<td>Water Supply Reliability</td>
<td></td>
<td></td>
<td>$59.9</td>
</tr>
<tr>
<td>Integrated regional water management</td>
<td>Local</td>
<td>DWR</td>
<td>$32.8</td>
</tr>
<tr>
<td>Water conservation</td>
<td>State/Local</td>
<td>DWR</td>
<td>$23.2</td>
</tr>
<tr>
<td>Improvements to state water system</td>
<td>State</td>
<td>DWR</td>
<td>$3.3</td>
</tr>
<tr>
<td>Stormwater management</td>
<td>Local</td>
<td>SWRCB</td>
<td>$0.6</td>
</tr>
<tr>
<td>Groundwater Sustainability</td>
<td></td>
<td></td>
<td>$21.9</td>
</tr>
<tr>
<td>Groundwater management</td>
<td>State/Local</td>
<td>DWR</td>
<td>$21.3</td>
</tr>
<tr>
<td>Groundwater contamination</td>
<td>State/Local</td>
<td>SWRCB</td>
<td>$0.6</td>
</tr>
<tr>
<td>Total*</td>
<td></td>
<td></td>
<td>$532.5</td>
</tr>
</tbody>
</table>

*Mainly allocated to state conservancies with a local focus.

Drought Proposal. Finally, the Governor proposes a second-year of drought funding in response to the ongoing low rainfall and snowpack. As shown in the following table, and as discussed previously, the Legislature appropriated over $838 million (mostly bond funds) in 2013-14 and 2014-15 for various drought-related programs. The budget proposes an additional $115 million ($93.5 General Fund), to continue many of these activities in 2015-16. Of this amount, over half is directed to the Department of Forestry and Fire Protection (CalFIRE) for expanded fire suppression and prevention activities.
Drought Plan
Governor’s Proposed Allocations
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Purpose</th>
<th>2014-15 (Actual)</th>
<th>2015-16 (Proposed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased fire suppression and prevention</td>
<td>$66</td>
<td>$62</td>
</tr>
<tr>
<td>Emergency drinking water supplies</td>
<td>$0</td>
<td>$16</td>
</tr>
<tr>
<td>Actions to protect fish and wildlife</td>
<td>$39</td>
<td>$15</td>
</tr>
<tr>
<td>Emergency water supply and education</td>
<td>$18</td>
<td>$12</td>
</tr>
<tr>
<td>Emergency regulations and enforcement</td>
<td>$4</td>
<td>$7</td>
</tr>
<tr>
<td>Drought response coordination</td>
<td>$4</td>
<td>$4</td>
</tr>
<tr>
<td>Food assistance</td>
<td>$5</td>
<td>*</td>
</tr>
<tr>
<td>Groundwater cleanup and management</td>
<td>$9</td>
<td>$0</td>
</tr>
<tr>
<td>Water conservation in state facilities</td>
<td>$5</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$151</strong></td>
<td><strong>$115</strong></td>
</tr>
</tbody>
</table>

* Does not reflect $7 million carryover from 2014-15

** $687.4 million was appropriated in 2013-14 as part of the 2014 drought package. This amount focused on integrated regional water management grants, flood control and accelerating the Governor’s water proposals.

ISSUES FOR CONSIDERATION

What is the Greatest Need of Local Communities for State Assistance? Given that most water funding takes place at the local level, the Legislature should consider the state's greatest need when allocating state dollars for local assistance. For example, poor quality drinking water in some communities was among many issues raised by stakeholders during the previous year’s reorganization of the state’s drinking water programs. Parts of the Central Valley have ongoing water quality problems that result in a complete lack of safe drinking water. These issues have been well-documented, but have not been sufficiently addressed. This problem is not isolated to the Central Valley and persists in many lower-income and disadvantaged communities which may not be able to raise the financial capital needed to address the problems.

In addition, local areas in the Delta are unable to fully pay for levee repairs. While this may not ordinarily rise to the level of a state concern, the need for water to move through the Delta statewide needs gives the Legislature an ongoing interest.

Finally, in many low-income and disadvantaged areas, local planning has reduced access to clean water sources and watershed activities. For example, in the Los Angeles basin, decisions in the
early 1900’s to concrete rivers in order to avoid local flooding had the secondary effect of reducing urban greenways, and the potential for groundwater recharge. Many of these communities are unable to reverse this action without significant outside funding. The Legislature may wish to consider how and where to fund these types of projects.

**How can Disadvantaged Communities Better Access Funding?** During the negotiations related to reorganization of the drinking water programs from the Department of Public Health to the SWRCB, several local stakeholders proposed the inclusion of an office within the SWRCB to provide more direct access for disadvantaged communities to revolving loan funds for drinking and wastewater. The Legislature may want to consider legislation that would ensure those with the greatest need have an advocate within the state administration to help access necessary resources.

**How Should the State Respond if the Drought Continues?** The state may be entering a historic period of drought. Given climate change and the state’s propensity for long-term drought scenarios, the Legislature should consider how it wishes to address drought funding. To be sure, immediate needs such as food and emergency drinking water assistance cannot be avoided. However, the Legislature should also consider that very few of the past 100 years have been “normal water years.” California either has too much or, more often than not, too little water. Given this history, how can the state and local communities become more self-reliant and resilient to the obvious and ongoing fluctuations of water supply within the state.

**Should the Legislature Advance Flood Funding as Proposed by the Governor?** In its debate of the Governor’s proposal to approve a water proposal prior to the normal budget cycle, the Legislature should consider several factors, including, but not limited to: high need projects, and projects that benefit underserved communities, for which early approval would benefit the state and local communities; the ability of DWR to move funding in a timely fashion; whether early funding is for scheduled and ongoing projects or new projects; the necessity of a 10-year appropriation authority; and how to best ensure important legislative oversight and expenditure authority.

**What Alternatives Should the Legislature Consider?** The idea of an early water bill is not new. However, the Legislature should consider what it wants to accomplish with an early water bill. Is the purpose of the bill to get funding to local areas to begin new projects and to create water supply reliability in the short- and long-term? If so, the Proposition 1 bond fund and drought proposals may accomplish this more aptly than ongoing flood funding. Within the drought proposal, the Legislature should consider early funding only for those programs that could begin moving funding out the door prior to the June 15 budget deadline. For example, CalFIRE received $66 million from the 2014 drought package for a full year of fire suppression and prevention activities. Would advancing additional funds to CalFIRE before July 1 make fiscal sense? What oversight might budget committees wish to exercise prior to additional appropriation?

**What is the Role of Budget Oversight?** Finally, the budget committees are committed to providing robust oversight and have done so in recent years. The Governor’s budget proposals, while consistent with previous years and the voter-approved bonds, should be evaluated
thoroughly, particularly those that depart from the norm (such as a 10-year appropriation authority for flood projects). The Legislature should consider what level of scrutiny is necessary for each category of appropriation and only advance funding for those projects that do not require extensive legislative oversight.
Environmental License Plate Fund

BACKGROUND

Personalized License Plates. The Legislature created the personalized license plate through the enactment of Chapter 779, Statutes of 1970. Revenues from personalized license plates, purchased by individuals, are collected by the Department of Motor Vehicles (DMV), and, deposited into the Environmental License Plate Fund (ELPF). State law requires that for certain plates, such as the Yosemite Conservancy Plate and the California Coastal License Plate (Whale Tail), the DMV collect additional revenues that are deposited directly into separate funds (the Yosemite Fund and California Beach and Coastal Enhancement Account, respectively). The remaining funding supports the Environmental Protection Program (EPP), which addresses the preservation and protection of California’s environment, as prescribed by law.

In 2011-12, over 82,000 plates were purchased. Half of these were purchased for special programs (such as the Whale Tail and Yosemite plates), and half were generic environmental personalized license plates. Over one million plates have been purchased and are renewed annually. Revenues from the plates average $41 to $42 million per year from new purchases and renewals.

Environmental License Plate Fund (ELPF). The ELPF was established to provide funding to various environmental programs through the EPP at the state and local level. The amount of funding available is dependent upon the number of certain specialty license plates sold and maintained in the state. Traditionally, the fund has been allocated to natural resource programs. The main priorities of the ELPF, as designated by Public Resources Code 21190 and include:

1. The control and abatement of air pollution.
2. Acquisition, preservation, and restoration of ecological reserves.
3. Environmental education, including formal school programs and informal public education programs.
4. Protection of nongame species and threatened and endangered plants and animals.
5. Protection, enhancement, and restoration of fish and wildlife habitat.
6. Purchase of real property for state and local parks.
7. Reduction or minimization of soil erosion and sediment discharge into Lake Tahoe.
8. In addition to these, SB 861 (Committee on Budget), Chapter 35, Statutes of 2014, added climate assessment to the eligible list of priorities.

Allocation of Funds. The allocation of funds within the program is subjective. The Administration reviews revenues and provides the Legislature with a proposed funding package each January. As discussed in a 2012 audit of the program, the Resources Agency is required to provide reports and programs recommended for funding, together with a statement of their purposes, the benefits to be realized, and the Secretary for Natural Resource’s commitment for inclusion in the Governor’s budget. This report is required to be submitted annually to the Governor with the request for funding. According to the 2012 audit, this information had not
been provided and the agency’s response was that the report was duplicative of the budget change proposal process already occurring.

**Shifting Priorities and New Programs.** As shown in the figure below, shifting priorities have altered how ELPF funding has changed. For example, in 1990, the Department of Fish and Wildlife (DFW) accounted for 40 percent of ELPF expenditures. The budget display reflected numerous ongoing and capital programs. Conservancies made up a relatively small proportion of the budget in 1990, but jumped to 35 percent in the proposed 2015-16 budget. Over the years, new programs have been added to the ELPF budget. For example, the California Natural Resources Agency (CNRA) proposes to spend $6.7 million of the overall allocation primarily for two relatively new programs—the Ocean Protection Council (formerly housed at the State Coastal Conservancy) and the Fourth Climate Assessment (first proposed in 2014-15).

**Environmental License Plate Fund**  
**Expenditures (by percentage)**  
**1989-90 versus 2014-15**

![Bar chart showing Expenditures (by percentage) Environmental License Plate Fund 1989-90 versus 2014-15](image)

**Stable Revenues.** The ELPF revenues have hovered between $39 and $41 million for over eight years. However, in the Governor’s budget, in multiple years, the Administration has forecast higher revenues (as much as $45 million). When a final reconciliation of the budget has been made, these higher forecasts have never been realized. In 2014-15, the budget forecast revenues of $44 million. However, currently estimated revenues (as shown in the 2014-15 budget display), are forecast to be $41 million. A similar pattern has occurred over multiple years.
Conservancies—Funding Baseline Expenditures. In recent years, the ELPF has been used to backfill state operations expenses at state conservancies where bond funds have been exhausted. In most cases, this consists of state operations of less than $500,000. However, certain conservancies receive a greater proportion (Tahoe) due to statutory requirements and ties to specific license plates. The coastal agencies receive funding directly from the Whale Tail license plate in another fund.

In November 2014, voters approved the Water Quality, Supply, and Infrastructure Improvement Act of 2014 (Proposition 1). The bond makes available $7.5 billion in general obligation bond funds for projects that improve water supply, protect and restore watersheds, improve water quality, and increase flood protection. The majority of funds are designed to be allocated to existing state programs that provide grants and loans to local entities. This bond allocates approximately $100 million directly to state conservancies for ongoing and capital projects. The bond also allows for five percent of the full allocation to be used over the life of the bond expenditures and encumbrance periods, for baseline state operations expenses (salaries, office expenses, etc.).

### State Conservancies Funding—ELPF and Proposition 1
#### 2015-16
#### (Dollars in Thousands)

<table>
<thead>
<tr>
<th>Conservancy</th>
<th>ELPF</th>
<th>Prop 1</th>
<th>Total</th>
<th>5% for State Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tahoe*</td>
<td>$3,582</td>
<td>$14,150</td>
<td>$15,000</td>
<td>$750</td>
</tr>
<tr>
<td>Coastal**</td>
<td>$1,300</td>
<td>$15,000</td>
<td>$100,500</td>
<td>$5,025</td>
</tr>
<tr>
<td>Santa Monica Mountains***</td>
<td>$308</td>
<td>$12,640</td>
<td>$80,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>Los Angeles River/Mountains***</td>
<td>$369</td>
<td>$19,700</td>
<td>$80,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>San Joaquin River</td>
<td>$312</td>
<td>$2,800</td>
<td>$10,000</td>
<td>$500</td>
</tr>
<tr>
<td>Baldwin Hills</td>
<td>$377</td>
<td>$2,100</td>
<td>$10,000</td>
<td>$500</td>
</tr>
<tr>
<td>San Diego River</td>
<td>$374</td>
<td>$4,100</td>
<td>$17,000</td>
<td>$850</td>
</tr>
<tr>
<td>Coachella Valley</td>
<td>$303</td>
<td>$2,570</td>
<td>$10,000</td>
<td>$500</td>
</tr>
<tr>
<td>Sierra Nevada*</td>
<td>$4,406</td>
<td>$10,200</td>
<td>$25,000</td>
<td>$1,250</td>
</tr>
<tr>
<td>Delta</td>
<td>$77</td>
<td>$9,871</td>
<td>$50,000</td>
<td>$2,500</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>$11,408</td>
<td>$93,131</td>
<td>$397,500</td>
<td>$19,875</td>
</tr>
</tbody>
</table>

* Tahoe received funding in proportion to the amount raised by the Lake Tahoe license plate.

** $1.3 million to SCC is one-time allocation. Baseline ELPF to SCC was shifted to OPC.

*** In addition to $30 million per conservancy, SMMC/RMC share $100,000 for the LA River.
**Whale Tail—A Special License Plate.** According to the DMV Website: “The fees collected for the Whale Tail License Plates, sponsored by the California Coastal Commission, help protect and restore the priceless resources of California's coast and ocean.” In reality, the allocation of funds from this special license plate is more complex.

The California Coastal Commission’s Whale Tail License Plate was established as a mechanism through which the public can contribute funds to coastal and marine education programs in California. For each new plate that is sold, approximately $13.97 is deposited in the California Beach and Coastal Enhancement Account (CBCEA). Annual renewal fees deposit approximately $19.77 per plate into the account. Additional funds are deposited in the Environmental License Plate Fund (ELPF), which funds environmental programs in other state agencies. As of December 31, 2013, a total of 218,945 license plates have been sold. Whale Tail License Plate sales and renewal fees (plus miscellaneous other small fees) have contributed $21.8 million to the CBCEA, and $53.7 million to the ELPF. (The additional fees that are charged for personalized plates go to the ELPF.)

### Coastal Beach and Enhancement Account
#### Revenues and Expenditures 2010-2015
(Dollars in Millions)

![Graph showing Coastal Beach and Enhancement Account Revenues and Expenditures 2010-2015](image)

**2014 Audit of ELPF.** In 2013-14, the State Auditor reviewed the specialized license plate program. As a part of that audit, the auditor reviewed multiple funds receiving revenues from specialized license plates, including the ELPF, and in particular expenditures for the Department of Fish and Wildlife (DFW), Department of Parks and Recreation (CDPR), and Natural Resources Agency (CNRA). In brief, the overall audit concluded that the DMV should do a better job of collecting revenues for the plates, and several agencies could not demonstrate that the state received the intended benefit from the plate revenues. Specifically, the audit concluded:

- The DMV had not collected the appropriate amount of fees and had not claimed its administrative costs accurately. The DMV overcharged the ELPF by $2.1 million per year from 2009-10 through 2011-12.
• The CDPR and CNRA could not provide sufficient support for their expenditures or a rationale for the portion of shared costs that they charged to the environmental fund, nor for the manner in which they allocated costs to the fund.

• The CNRA could not justify why it had paid the entirety of the secretary’s salary in a single month (April 2010) from the ELPF, rather than proportionally.

• The CNRA has not submitted to the Governor and Legislature required reports intended to provide pertinent information about the performance of programs and projects paid for by the fund. Specifically, the CNRA must forward reports on those projects and programs recommended for funding, together with a statement of their purposes, the benefits to be realized, and the secretary’s comments for inclusion in the Governor’s budget.

A review of the Governors’ budget showed that in 1990, the CNRA and its respective departments provided specific and detailed information about the nature of ELPF expenditures. Projects were identified in the Governor’s budget and backup justification for each project and program was included for review by the Legislature.

The current report forwarded by the CNRA repeats statutory guidance provided to the departments. For example, the following was provided:

**0540 Natural Resources Agency**

ELPF funds state operations of the secretary for natural resources (Natural Resources Agency). The mission of the agency is to restore, protect and manage the state’s natural, historical and cultural resources. The secretary for natural resources, a member of the Governor's Cabinet, sets the policies and coordinates the environmental preservation and restoration activities of 26 various departments, boards, commissions, and conservancies, and directly administers the Sea Grant Program, California Environmental Quality Act, and River Parkways Grant Program. In addition, the secretary, per Public Resources Code (PRC) 21193 is responsible for the administration of the Environmental License Plate Fund and oversight of the funds expenditures.

In reality, the CNRA intends to expend over $6.7 million dollars on specific programs including the Fourth Climate Assessment and the Ocean Protection Council (all-base funding). This information was not included in the justification for the budget request. It should be noted that the Whale Tail plate funding, administered by the Coastal Commission and State Coastal Conservancy, under multiple reviews, has been found to be justified by recent audits.

By contrast, the DFW was able to identify how it would spend its entire $15.5 million allocation, the majority of which would fund biodiversity programs. However, a full $4.3 million was identified as general and unspecified overhead within the department.

**GOVERNOR’S PROPOSAL**

**Governor’s Proposal.** The Governor’s budget proposes $38.8 million in expenditures and $42 million in revenues. After required transfers to the Motor Vehicle Account ($2.4 million), the
amount available for expenditure is $39 million. The figure below outlines ELPF expenditure proposals for the current year and budget year.

### Environmental License Plate Fund
#### 2015-16 Proposed Expenditures
(Dollars in Thousands)

<table>
<thead>
<tr>
<th>Function</th>
<th>2014-15 (Estimate)</th>
<th>2015-16 (Proposed)</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Fish and Wildlife</td>
<td>$15,511</td>
<td>$9,468</td>
<td>-39%</td>
</tr>
<tr>
<td>Conservancies</td>
<td>$10,235</td>
<td>$11,408</td>
<td>11%</td>
</tr>
<tr>
<td>Secretary for Natural Resources</td>
<td>$4,561</td>
<td>$6,703</td>
<td>47%</td>
</tr>
<tr>
<td>Natural Resource Agency Departments</td>
<td>$5,380</td>
<td>$5,330</td>
<td>-1%</td>
</tr>
<tr>
<td>Tahoe Regional Planning Agency</td>
<td>$3,998</td>
<td>$3,998</td>
<td>0%</td>
</tr>
<tr>
<td>Department of Parks and Recreation</td>
<td>$3,058</td>
<td>$0</td>
<td>-100%</td>
</tr>
<tr>
<td>Cal-EPA boards and Departments</td>
<td>$1,454</td>
<td>$1,456</td>
<td>0%</td>
</tr>
<tr>
<td>Department of Education</td>
<td>$414</td>
<td>$410</td>
<td>-1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$44,611</strong></td>
<td><strong>$38,773</strong></td>
<td></td>
</tr>
</tbody>
</table>

**ELPF Shortfall.** According to the Administration, revenues in the ELPF are not likely to meet budgeted projects by as much as $3 million in both the current year (2014-15) and the budget year (2015-16). The shortfall occurred mainly because the Administration over-estimated revenues to the program. As discussed previously, revenues to the program historically averaged between $39 to $41 million per year. The Administration raised the revenue estimate in 2014 to $45 million. Additional cost pressures are salary adjustments required by the “like-pay for like-work” initiative.

The Administration proposes a series of actions to address the shortfall. In the current year (2014-15), the solutions include:
- Delay the beginning of the 4th Climate Assessment from the current year to budget year ($2.5 million).
- Delay the Climate Ready grants from current year to budget year ($1.3 million).
- Shift expenditures in CDPR and DFW to special funds ($1.1 million).
- Other, targeted reductions.

In 2015-16, the proposed solutions include:
- Move the remaining 4th Climate Assessment funding out one year ($2.5 million).
- Shift $3.3 million in CDPR to the State Parks and Recreation Fund.
- Shift $7.2 million in DFW to Fish and Game Preservation Fund.
- Introduce trailer bill language to increase plate fee by five percent (estimated new revenue of $1 million).
- Additional targeted reductions to departments ($1.1 million).
ISSUES FOR CONSIDERATION

Should the Fourth ELPF be Used for Climate Strategy? Using $5 million in 2014-15 from the ELPF to fund the CNRA’s Climate Adaptation Assessment, should be reviewed. The ELPF was designed to fund state environmental education efforts that have, to date, been funded with a variety of recycling funds and other environmental fees. Previous climate assessments had been funded through the public goods charge. The Administration suggested that cap-and-trade auction revenues would not be appropriate for the assessment but did not provide a legal opinion supporting that statement. The climate assessment proposal was rejected by budget subcommittees, and an alternative proposal—funding direct climate resilience (direct adaptation) was adopted. During final budget negotiations, the Administration assured the Legislature that sufficient funding was available in the ELPF for both the fourth Climate Assessment the Climate Resilience Account ($1.3 million).

The Legislature may wish to consider rejecting the 4th Climate Assessment (given that funding for this was based on false projections), and revisit the idea of funding all climate activities through other funds (such as cap-and-trade auction revenues).

Should the Legislature Consider Revisiting Conservancy ELPF Funding? As shown in Figure 2, aside from revenues from specific plates, ELPF funding appears to be fairly random in its allocation. Long-established conservancies (State Coastal Conservancy, for example) receive no baseline/state operations funding while the Sierra Nevada Conservancy receives $4.4 million per year. The Santa Monica Mountains and LA River Conservancies receive $308,000 and $369,000 by comparison. These conservancies have traditionally been funded by bond funds given that their main purpose is acquire and develop land for conservation status (parks, watersheds, view-sheds, trails, etc.). As the figure shows, a full five percent of allocations from bonds can be used for state operations. This is considered the amount necessary to administer a capital outlay program. For many of the smaller agencies, the addition of the five percent may not be sufficient to pay for their ongoing state operations, but for some this amount is very significant. For example, the Delta Conservancy receives $77,000 from the ELPF for state operations. The five percent bond allocation is $2.5 million. Is the $77,000 still necessary?

Why are Education and Environmental Protection Such a Low Priority? The statute guiding the distribution of the ELPF clearly identifies the following priorities: (1) the control and abatement of air pollution; and, (2) environmental education. Respectively, these priorities receive four percent and one percent of the funding allocated to ELPF. At the same time, the state continues an initiative to bring environmental education into the core curriculum of all classrooms in the state through the Education and the Environment Initiative. The Legislature should consider whether funding distributed pursuant the statute (PRC 21190) is being equitably distributed, or if there should be statutory language directing the allocation of funds in a more definite manner.

Do Plate Owners Really Think This is How We Spend the Money? One of the more challenging questions legislator’s face is what the purchasers of the specialized license plates believe funding is going toward. For example, if PRC 21190 states that one priority is “purchase of real property for state and local parks,” how is this being brought to fruition? Base state
operations funding at state parks and the conservancies does not accomplish this goal. Removing all state parks funding (as is proposed in the 2015-16 budget), would not accomplish this goal. So, too, if the DMV website says that purchase of the Whale Tail plate would “help protect and restore the priceless resources of California's coast and ocean,” would the same purchaser think that funding non-coastal agencies is part of their purchase-package? The Legislature could consider, as part of its review of the ELPF, any number of other ways of distributing funding for the ELPF and other specialty plates more in keeping with what the purchasers expect.
Transportation

BACKGROUND

Overview of Transportation Funding in California
The California state highway system includes 50,000 lane-miles of pavement, 12,599 bridges, 205,000 culverts and drainage facilities, 87 roadside rest areas, and 29,183 acres of roadside landscaping. In addition, California’s 58 counties and 480 cities own and maintain 304,000 miles of local streets and roads, as well as numerous local bridges. Approximately, 200 public agencies provide some kind of public transit service that results in about 1.3 billion passenger trips each year. The modes of transit include intercity bus and passenger rail. The programs described in this section relate to state highways, local roads, and mass transit, and include the Department of Transportation (Caltrans) and the California Transportation Commission (CTC).

These areas of transportation are funded from multiple sources at the local, state, and federal levels as shown in the figure below. In addition, the California Highway Patrol (CHP), the Department of Motor Vehicles (DMV), as well as various programs within the Air Resources Board (ARB), are funded with revenues from vehicle registration and driver licenses’ fees. High-speed rail funding is excluded here and is discussed in the following section.

Major Sources of Transportation Funding
Fiscal Year 2015-16
(Dollars in Billions)

<table>
<thead>
<tr>
<th>Funding Source</th>
<th>Annual Amount</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Revenues</td>
<td>$14.1</td>
<td>Locally-imposed revenues such as add-on sales tax, property tax, developer fees, and transit fares. Some funds used to reimburse Caltrans for locally-supported work on the highway system. (2014-15 estimated revenues.)</td>
</tr>
<tr>
<td>Federal Revenues</td>
<td>$4.6</td>
<td>Primarily federal gas tax revenue (18.4 cents/gallon) but augmented by General Fund. Includes funds for highways (Caltrans) and transit (local agencies).</td>
</tr>
<tr>
<td>State gasoline and diesel excise tax</td>
<td>$4.9</td>
<td>Allocated to the state and local governments from the 30.5 cent state gasoline excise tax and 11 cent diesel excise tax.</td>
</tr>
<tr>
<td>Fees on cars and drivers</td>
<td>$3.1</td>
<td>Primarily from vehicle registration and driver licenses. Supports the operations of the DMV, CHP, and ARB.</td>
</tr>
<tr>
<td>Truck weight fees</td>
<td>$1.0</td>
<td>Revenue supports debt service and interest on transportation-related general obligation bonds.</td>
</tr>
<tr>
<td>Diesel sales tax</td>
<td>$0.6</td>
<td>Primarily supports local transit operators.</td>
</tr>
<tr>
<td>GO bonds</td>
<td>$2.4</td>
<td>State general obligation bonds, primarily from Prop 1B.</td>
</tr>
<tr>
<td>Total</td>
<td>$30.7</td>
<td></td>
</tr>
</tbody>
</table>
Sources of Funding for Transportation Projects

California’s transportation system receives funding primarily from local, state, and federal governments. Regional and local governments provide about half of the state’s transportation funding, and state and federal governments each provide about one quarter of the state’s total funding, in 2014-15. According to the Legislative Analyst’s Office (LAO), in 2013, the average California driver paid $220 in state fuel taxes and $110 in federal fuel taxes. Below we describe these three sources of funding in more detail.

Local Funding. Local sales tax measures, the Transportation Development Act, transit fares, and other funding sources such as local general funds, property taxes, and developer fees provide additional funding for various transportation purposes. Nineteen counties (also known as self-help counties) have approved measures that allow them to adopt a sales tax increase for transportation programs—subject to two-thirds local voter approval—that generally last between 20 to 30 years. In addition, four transit authorities have approved permanent local tax measures.

State Funding. State funding for transportation comes primarily from revenues derived from taxes and fees. The three main state revenue sources are: (1) the state gasoline and diesel excise tax, (2) truck weight fees, and (3) the sales tax on diesel fuel. The base of these taxes has diminished over time as vehicles have become more fuel-efficient or use alternative energy sources not subject to state taxes. As a result, the traditional funding sources have not kept pace with the demands of a growing population and an aging transportation system. The 2015-16 budget estimates that fuel tax revenues in the budget year will be $769 million less than they were in 2014-15. This results in a significant loss of funding for state and local roads.

In addition, the state funds transportation projects with general obligation (GO) bonds. The most recent transportation bond approved by the voters—the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B)—provided $19.9 billion for a variety of transportation projects. However, most of this funding is committed to projects and will be fully expended in the next few years as these projects are completed.

Federal Funding. The Highway Trust Fund, the source of most federal funding for the country’s roads and transit infrastructure, has seen revenue fall short of expenditures for more than a decade. Drawing down trust fund balances and transferring money from the general fund have served as temporary fixes, but have not addressed the underlying issue of declining revenue from the federal fuel excise tax of 18.4 cents/gallon gasoline and 24.4 cents/gallon diesel fuel. The Congressional Budget Office projects that, absent reforms, trust fund shortfalls will grow to $162 billion over the next 10 years.

Roughly, 98 percent of federal funding for surface transportation flows to state and local governments, mostly in the form of reimbursements for expenses already incurred. Because projects require significant planning and construction time, it is important for state and local governments to have some certainty and consistency in funding. Historically, this has been the reason federal funding was authorized for multiple years; however, the last full federal funding authorization (six years of funding) was passed nearly a decade ago and state and local governments have been operating under short-term funding extensions since then. Funding
uncertainty and declining revenues present challenges for planning and investment in transportation projects.

**Maximize the Use Existing Funding**

It is important to ensure that Caltrans maximizes the use of existing funding for capital projects. One way to do this is to have the department identify savings and efficiencies that it could implement to reduce the amount it spends on capital outlay support (COS), or funding for staff. In 2013–14, Caltrans spent $1.8 billion to support 10,149 full-time equivalent staff for the COS program. Reducing capital outlay support costs frees up funding that could be used for capital projects to improve the state’s highways and bridges.

Some other ways to achieve greater efficiency in the delivery of transportation projects include using competitive funding grants and cost-benefit analyses to evaluate proposals, and ensuring that the state funds provided encourage investment in high-value projects.

**Transportation System Needs Exceed Available Funding**

Both the state’s highway system and local roads are in poor condition according to various studies. Moreover, recent assessments have found that the state’s transportation needs are great and the funding to address those needs is inadequate. For example, in 2011, the California Transportation Commission Statewide Transportation System Needs Assessment found that the total cost of all system preservation, management, and expansion projects during the ten-year study period was nearly $538.1 billion. Of this total, about 63 percent of the costs are for rehabilitation projects and maintenance costs based on the goal of meeting accepted standards that would bring transportation facilities into a “state of good repair” within the study period. The remaining costs were for system management and expansion projects.

**Options to Increase State Funding**

Various options can be implemented to provide additional state funding for transportation projects. The table below summarizes the pros and cons of some key options. A single option may not be the best and most likely a combination of options would help to balance some of the advantages and disadvantages of the various options described below. Moreover, some of the options described below are regressive, meaning the cost imposes a proportionally greater burden on lower-income people. However, regressive impacts can be offset by making investments in public transit for those who do not use automobiles as their primary form of transportation. Other ways to mitigate regressive impacts are to provide exemptions, tax credits, or preferential rates to lower income groups. Lastly, this list of options is not exhaustive and other approaches or variants of these approaches should be explored.
State Funding for Transportation Projects
Various Options

<table>
<thead>
<tr>
<th>Option</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mileage-based user fee</td>
<td>Can be implemented statewide, addresses increasing fuel efficiency of vehicles, can be indexed to inflation.</td>
<td>Regressive, does not address congestion, privacy and implementation concerns.</td>
</tr>
<tr>
<td>Tolls/ road pricing</td>
<td>Can address congestion in urban areas.</td>
<td>Regressive and cannot be implemented statewide. Amount of revenue generated uncertain.</td>
</tr>
<tr>
<td>Increase fuel tax</td>
<td>Targets larger and less-fuel efficient vehicles.</td>
<td>Regressive and politically challenging to increase.</td>
</tr>
<tr>
<td>Increase vehicle weight fees</td>
<td>Would better align costs that heavy trucks impose on roads with the amount paid.</td>
<td>Could have a somewhat negative economic impact.</td>
</tr>
<tr>
<td>Increase vehicle-related fees</td>
<td>Can be implemented statewide. Low administrative costs.</td>
<td>Regressive. Public resistance. One-time sticker shock.</td>
</tr>
<tr>
<td>Public-private partnerships</td>
<td>Can provide funding the state would not otherwise have for specific projects.</td>
<td>Limited use and would not generate on-going statewide revenues.</td>
</tr>
<tr>
<td>Bonds</td>
<td>Provides dedicated funding for transportation projects.</td>
<td>Does not generate new revenue and commits future revenues.</td>
</tr>
</tbody>
</table>

**Mileage-Based User Fee.** A mileage-based user fee charges users of the system an amount that is proportionate to the amount they drive, or vehicle miles traveled (VMT). This approach would address the declining use of fuel and the associated revenue decline. A VMT could be established to adjust for inflation so that the revenue generated maintains its purchasing power. An advantage of a VMT fee is that it can be implemented statewide. Some of the concerns related to implementing a VMT fee include that the fee paid would be regressive and this approach does not address congestion by discouraging driving during peak periods. In addition, significant work would need to be done to address privacy issues and obtain the public’s support. A recent report by the University of Southern California, Sol Price School of Public Policy, estimated that a 2.1 cents per mile VMT fee would raise enough revenue to replace the current state excise and sales tax on gasoline. It also found that for each 0.42 cent per mile increase in the fee an additional $1 billion in revenue is generated. However, this amount varies significantly based on fuel efficiency of vehicles and the number of miles driven.

**Tolls/Road Pricing (Congestion-Based Pricing).** Tolls charge a fee to drive on certain roads and is conceptually based on the value of time saved by using that specific road. Toll roads can help to address congestion, especially in urban areas and can result in the more efficient use of scare resources (uncongested roads) during peak travel periods. However, this approach does not address issues of congestion throughout the state and would not generate enough revenue to maintain the state’s existing system.
**Increase the Fuel Tax.** Some support increasing the state fuel tax to keep pace with inflation. This would help the state to maintain its purchasing power. One benefit of this tax is that larger and less fuel-efficient vehicles, that cause a disproportionate amount of road pollution and damage, pay more taxes. However, this tax is regressive and increasing the tax is likely to be politically challenging. Also, this tax does not proportionally account for the wear and tear caused by vehicles using the state transportation system that do not rely, or rely less heavily, on gasoline.

**Increase Vehicle Weight Fees.** Trucks currently pay vehicle weight fees that are not proportionate to the costs that these vehicles impose on the state’s transportation system. An increase in the fees that trucks pays would likely receive much opposition and potentially have a somewhat negative economic impact because it may increase the costs of goods and services.

**Increase Vehicle-Related Fees.** The state imposes various vehicle-related fees that include the vehicle license fee (VLF) and the vehicle registration fee. Since the state already collects these fees, the administrative costs of this option are low and can easily be implemented statewide. Increases in such fees could potentially generate significant revenue. For example, Transportation California estimates that increasing the existing VLF by one percent, to 1.65 percent of vehicle value, would generate $3 billion in new revenue annually. However, increasing such fees would be met with great public resistance and the annual one-time bill could result in “sticker shock” for the public. This approach also does not encourage the purchase of more fuel-efficient vehicles or address congestion.

**Public-Private Partnerships (PPP).** Through a PPP, public agencies partner with a private entity to share responsibility for the completion, management and/or financing of a public project. A PPP can potentially provide access to funding that is not otherwise available for transportation projects and may allow for a project to be completed more quickly, sometimes reducing project costs. A PPP can also be structured so that the private partner can impose a toll on the roadway in order to generate revenues to pay for the project. While PPPs can provide funding for a specific project, their use is limited and the benefits potentially short-term. The use of PPPs would not generate on-going statewide revenues for transportation projects.

**Bonds.** The state can sell bonds to finance transportation projects. However, this approach does not generate new revenues and commits future revenues. This approach also has the downside of not affecting taxpayers in a way that the amount they pay is proportionate to their use, or cost imposed on the system.

**Options to Increase Local Funding**

Below are two options specific to local governments for increasing the amount of funding available for transportation projects.

**Reduce Approval Threshold for Local Transportation Sales Tax Measures.** State law allows counties to impose a sales tax for local transportation purposes. Proposition 62, passed in 1986, requires such a tax be approved by a supermajority, or two-thirds of those voting. Twenty counties, representing 81 percent of the population, have adopted such a tax. The two-thirds threshold could be lowered, making it easier for local governments to pass these taxes. While
these taxes can create a significant amount of new revenue for local transportation projects, they
do not encourage fuel-efficiency, are regressive, and may not help to comprehensively address
the state’s transportation needs.

**Locals Can Impose Transportation Impact Fees.** These are fees paid by developers based on
the transportation costs imposed by their projects. For example, a developer may be required to
pay for roadway improvements, public parking facilities (called in-lieu fees), funding for a
transportation management association, walking and cycling improvements, or other programs
that mitigate local traffic impacts.

**GOVERNOR’S PROPOSAL**

**Pilot of a Mileage-Based Revenue Collection System**
The Governor’s budget proposes five limited-term positions at Caltrans ($9.4 million, State
Highway Account), in addition to one limited-term position ($136,000, Public Transportation
Account) at the California Transportation Commission, to implement a road usage charge pilot
program, pursuant to Senate Bill 1077 (De Saulnier), Chapter 835, Statutes of 2014. The pilot
would explore a mileage-based revenue collection system to support the maintenance and
operations of the state highway system. Based on the recommendations of a technical advisory
committee, a pilot program is to be implemented by January 1, 2017 and a final report based on
the results is due June 30, 2018.

**Legislation to Expand Toll Roads**
The budget proposes legislation that will expand the California Transportation Commission’s
authority to approve new high-occupancy toll (HOT) lane projects, including converting existing
HOT lanes to toll lanes. This would maximize capacity on existing roads, in addition to
generating revenues.

**ISSUES TO CONSIDER**

Existing funding is inadequate to maintain the state’s current transportation system and it is
important for the Legislature to identify new funding options. According to the Governor’s
budget, the cost of deferred maintenance for the state highway system is $59 billion and the
annual funding shortfall for maintenance and repair of these roads is $6 billion. When
considering which options would be best to generate additional revenue for transportation
projects, Legislators may wish to consider the following questions:

- What are the state’s primary transportation goals and objectives? For example,
  maximizing traffic throughput on the state highways.
- Which options are the most stable, equitable, easy to administer, and support the state’s
  transportation goals and objectives?
- How much total annual revenue for transportation projects is necessary?
- Is the best approach to increasing funding a single approach or a package of approaches?
• Should the state move away from the gas tax and implement alternatives? If so, how?
• What is the appropriate balance of funding between resources provided by state and local governments?
• Is the use of currently available resources maximized for the purpose of transportation projects?
High-Speed Rail

BACKGROUND

The California High-Speed Rail Authority (HSRA) is responsible for directing the development and implementation of an intercity high-speed rail service that would be fully coordinated with other public transportation services. In November 2008, the voters approved Proposition 1A—the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century—which allows the state to sell up to $9.95 billion in general obligation bonds to partially fund the development (such as planning and environmental review) and construction of a high-speed rail system. Of this amount, $9.0 billion is for the high-speed rail system and $950 million to improve the connectivity of existing passenger rail systems with high-speed rail.

Up to $450 million of the $9.0 billion is available for general administration and up to $675 million is available for initial construction activities, such as environmental studies and preliminary engineering; no match is required for this $1.1 billion. The remaining $8 billion is available for construction; however, a non-bond match of at least 50 percent is required for each corridor or segment. Since the approval of Proposition 1A, HSRA has been awarded $3.5 billion in federal funds from the Federal Railroad Administration (FRA). These federal funds require a substantial state match and $2.3 billion of these funds must be spent by September 30, 2017.

The bond act specifies certain characteristics for the design of the system, including electrified trains capable of sustaining speeds of no less than 200 miles per hour and capacity to achieve travel times between San Francisco and Los Angeles Union Station of 2 hours, 40 minutes.

HSRA is led by a chief executive officer, and governed by a nine-member board, five of whom are appointed by the Governor, two by the Senate Committee on Rules, and two by the Speaker of the Assembly. It currently has 177 authorized staff positions.

Project Making Progress

The implementation of the high-speed rail project continues to move forward. The Legislature has appropriated approximately $7.2 billion ($3.9 billion in Proposition 1A funds and $3.3 billion federal funds) to begin development, right-of-way acquisition, and construction of the 130-mile Central Valley segment from Madera to just north of Bakersfield. In addition, in the 2014 Budget Act, the Legislature provided 25 percent of the ongoing cap-and-trade funds for the project. As a result, it faces fewer funding hurdles related to construction of the initial segments of the project. Groundbreaking to start construction of the initial 130-mile segment of the high-speed rail project between Madera and Bakersfield was held in Fresno on January 6, 2015.

Ensuring Appropriate Oversight

Development of high-speed rail is the largest, single infrastructure project the state has ever undertaken. To complete the high-speed rail project, the state is relying on a massive team of consultants that includes legal professionals, civil engineers, architects, mechanical-electrical
consultants, structural engineers, construction contractors, and construction managers. While the state is paying for all of these consultants, they all have other interests as well, which may conflict with the state’s priorities. As the owner of the project and to better ensure successful delivery of the project, the state needs to be very competent in its management of the managers and exercise strong advocacy for the state’s interests and priorities.

External, independent oversight and internal oversight are critical for project success. As shown in the figure below, the project currently has various types of oversight that include external oversight, a hybrid model, and internal oversight. External oversight largely consists of the State Auditor, which can be requested to conduct an audit, and the Peer Review Group, which consists of eight staff (currently four because vacancies have not been filled) which have a limited role in reviewing specific project documents. The board of directors provides both internal and external oversight of the project. It is largely a supporter and champion of the project, but as part of its board meetings it exercises oversight of the project as a whole and raises issues of concern. Contract staff provides services and oversees other project contractors. These include the program management (PMT) consultant, program management oversight (PMO), and project and construction management (PCM). In addition, state staff oversees these consultants, as well as other contractors. Finally, the HSRA has a small audit division which also provides internal oversight of the project.
## High Speed Rail Authority
### Various Types of Oversight Currently Exist

<table>
<thead>
<tr>
<th>Entity</th>
<th>Role</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>California State Auditor</td>
<td>Conduct periodic audits to ensure use of bond proceeds is consistent with state law.</td>
<td>External</td>
</tr>
<tr>
<td>Peer Review Group (8 positions, 4 vacancies)</td>
<td>Reviews and issues analyses of certain reports prepared by the Authority.</td>
<td>External</td>
</tr>
<tr>
<td>Board of Directors for the High-Speed Rail Authority</td>
<td>Project supporter that also provides high-level oversight.</td>
<td>Hybrid</td>
</tr>
<tr>
<td>Program Management (PMT) Consultant</td>
<td>Provides technical and contractual compliance assurance and manages program risks</td>
<td>Hybrid</td>
</tr>
<tr>
<td>Project Construction and Management (PCM) Consultants</td>
<td>Identifies, manages, and mitigates project risks and makes sure technical and contract requirements, including costs are met by overseeing design-build and construction contractors.</td>
<td>Hybrid</td>
</tr>
<tr>
<td>Program Management Oversight (PMO) Consultants</td>
<td>Identifies and tracks ongoing project tasks, work progress, and possible problem areas. Works with the PCM and HSRA staff to make adjustments and corrections to keep the project on schedule, within budget, and according to specifications.</td>
<td>Hybrid</td>
</tr>
<tr>
<td>HSRA Program Management Division (58 positions, 11 vacancies)</td>
<td>Responsible for project development, and direct and indirect oversight of activities conducted by specialists from the private sector.</td>
<td>Internal</td>
</tr>
<tr>
<td>HSRA Audit Division (7 positions, 1 vacancy)</td>
<td>Provides evaluations and recommendations concerning operational and programmatic deficiencies, and internal and external risks to the organization; strategies for managing organizational risks; and optimization of the internal control environment.</td>
<td>Internal</td>
</tr>
</tbody>
</table>

In addition, there are many other external agencies that provide oversight in particular areas. Some of these include the Legislature, the U.S. Congress, the Federal Railroad Administration, General Accounting Office, the California Transportation Agency, and environmental agencies.

### Adequacy of Current Oversight
The high-speed rail project is highly visible, expensive, complex, and significant for the development of the transportation system in California; and has implications for the nation’s transportation system. It is critical that the owners of this project, in this case the state of California, manage well the risk that is inherent in these types of projects and ensure that there is strong independent, external oversight. Currently, this type of oversight is limited, not coordinated, and sporadic; and moreover, it is unclear if it is adequate to ensure successful
delivery of the project. One way the Legislature can better ensure successful delivery of this important project is to improve external oversight.

**Models of External Oversight for Large Transportation Projects**

External oversight has an important role in ensuring successful project delivery. Below, some external models are described.

**Toll Bridge Program Oversight Committee (TBPOC).** The TBPOC was established by AB 144 (Hancock), Chapter 71, Statutes of 2005. The committee consists of the executive director of the Bay Area Toll Authority, the director of Caltrans, and the executive director of the California Transportation Commission. Its creation was prompted, in part, by significant cost overruns for the construction of the new east span of the San-Francisco-Oakland Bay Bridge. To help keep the project in check, TBPOC was tasked with performing project status reviews, reviewing program costs and schedules, resolving project issues, evaluating project changes, and developing and updating cost, estimates, risk assessments and cash-flow requirements. The Oversight Committee also reviews project staffing levels and consultant and contractor services, reviews contract bid specifications and documents, reviews and approves all significant change orders and claims, and prepares project reports.

**Oversight Coordination Commission.** The Central Artery/Tunnel Project in Boston, MA, also known as the “Big Dig”, is the largest completed public works project in the United States. The Big Dig experienced significant cost overruns and it was determined that the structure of the program lacked the mechanisms necessary to ensure that deficient performances would be detected and cost recovery pursued. In 1995, the Legislature established the Central Artery/Tunnel Project Oversight and Coordination Committee to monitor the project, and basically oversee the state overseers of the project. The committee acted as public auditors and was comprised of the Office of the Inspector General, the Massachusetts State Auditor, the Massachusetts House Oversight Committee and the Massachusetts Attorney General.

**Oversight Model for a Non-transportation Project.** The state’s Financial Information System for California (FI$Cal) project requires the California State Auditor to independently monitor the project. FI$Cal is a business transformation project for state government in the areas of budgeting, accounting, procurement, and cash management. The estimated total project cost is $673 million. The Auditor’s independent role includes monitoring the contracts for independent project oversight, independent verification and validation services, and assessing 1) whether concerns about the project are appropriately addressed, and 2) whether the project is progressing timely and within budget.

**Other Models.** A version of a federal oversight model could be created by installing an inspector general in every secretariat and authority that does private-sector contracting. Florida, for example, uses such an approach, with numerous inspectors general in cabinet offices, state agencies, and the state university system.
GOVERNOR’S PROPOSAL

The Governor’s budget for 2015-16 provides capital outlay funding of $1.7 billion to begin construction of the first section of the high-speed rail system extending from Madera to near Bakersfield, as shown in the figure below. The budget also proposes $1.1 billion to provide funds to local agencies for local/regional components of the high-speed train system and $30 million for state operations.

High-Speed Rail Expenditures
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Funding Source</th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Outlay</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proposition 1A</td>
<td>$24.6</td>
<td>$20.0</td>
<td>$224.0</td>
</tr>
<tr>
<td>Federal funds</td>
<td>1,290.0</td>
<td>616.0</td>
<td>1,192.0</td>
</tr>
<tr>
<td>Greenhouse Gas Reduction Fund</td>
<td>0</td>
<td>250.0</td>
<td>250.0</td>
</tr>
<tr>
<td>Subtotal capital outlay</td>
<td>1,314.6</td>
<td>886.0</td>
<td>1,666.0</td>
</tr>
<tr>
<td>Local Assistance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local projects</td>
<td>0</td>
<td>0</td>
<td>1,132.0</td>
</tr>
<tr>
<td>State Operations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Various state funds</td>
<td>23.7</td>
<td>30.2</td>
<td>30.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,338.3</strong></td>
<td><strong>$916.2</strong></td>
<td><strong>$2,828.2</strong></td>
</tr>
</tbody>
</table>

ISSUES TO CONSIDER

How to Structure Effective External Oversight
Successful delivery of the high-speed rail system is reliant upon well-managed relationships between public and private organizations driven by different, and at times, conflicting interests. Ensuring that the interests of the owner (the state) are strongly represented is critical to helping deliver a successful project. The Legislature can help to achieve this by improving external oversight of the high-speed rail project. Prior to the expenditure of large amounts of funding for construction is a good time to put such oversight in place. One approach could be to establish, within an independent state office, a small unit dedicated to conducting oversight of the program. This approach would allow for continuity and in-depth review of the project’s performance on an ongoing basis. In addition, the Legislature may want to establish a Select Committee of High-Speed Rail Oversight that could conduct oversight hearings and hold HSRA accountable for delivering a project that is consistent with the state’s expectations.

Meaningful Project Performance Measures
In addition to external oversight, it would be valuable for the Legislature, working with HSRA, to develop performance criteria that could be validly tracked over time and evaluated. Such performance measures could include comparisons of the estimated scope, cost, performance, and schedule for each of the project phases to actual results. In addition, it would be useful for HSRA
to identify all of the funds needed to complete the project and the timing of receipt of these funds and compare that information to the funds actually received. In addition, tracking over time the largest risks to the project, actions proposed to address those risks, and actions actually taken would be important. For specific project segments, performance could be tracked for: 1) right-of-way acquisition; 2) necessary permits obtained; 3) third-party agreements obtained; 4) the number and estimated cost of change orders; and 5) how quickly money is actually being spent compared to the estimated rate of expenditure (burn rate).

Maintaining the Peer Review Group
As mentioned earlier, the Peer Review Group provides external oversight of the high-speed rail project. The Administration has not worked to fill vacant positions in a timely manner. To help maintain this group, the Legislature may want to ask the Administration what its process is for filling vacancies on the Peer Review Group and to provide an update on the status of filling the four (of eight) vacant positions.
Subcommittee No. 3

Health and Human Services

Health
Medi-Cal – Managed Care Organization Tax ............................................................. 3-1
Medi-Cal – Coordinated Care Initiative................................................................. 3-6
Department of Public Health: Licensing and Certification of Health Facilities .... 3-12

Human Services
California Work Opportunity and Responsibility to Kids ..................................... 3-19
Child Welfare Services: Continuum of Care Reform ........................................... 3-27
Medi-Cal – Managed Care Organization Tax

BACKGROUND

California has had many variations of a tax on Medi-Cal managed care organizations (MCOs) over the last ten years. These include:

- **Managed Care Organization (MCO) Fee.** In 2005, California enacted a quality improvement fee (QIF) on Medi-Cal managed care organizations.\(^1\) Based on federal rules, the fee was assessed on all premiums paid to legal entities providing health coverage to Medi-Cal enrollees. When the fee was established, 75 percent of the revenue generated was matched with federal funds and used for payments to managed care organizations and the remaining 25 percent was retained by the state General Fund. Under this arrangement, the managed care organizations received a rate adjustment and on the net, health plans gained.

  Effective October 1, 2007, as part of the implementation of the state’s new managed care rate methodology, this arrangement changed and 50 percent of the revenue generated by the QIF was matched with federal funds and used for payments to managed care organizations and the remaining 50 percent was retained by the state General Fund.\(^2\) Under this allocation, managed care plans were made whole in that they were reimbursed the amount of QIF they paid, but no longer realized a net benefit.

  Changes in federal law resulted in this fee sunsetting on October 1, 2009, as it no longer complied with federal requirements. New federal law required that provider fees be broad based and uniformly imposed throughout a jurisdiction, meaning that they cannot be levied on a subgroup of providers, such as only those enrolled in Medicaid programs.

- **Gross Premiums Tax (GPT).** Assembly Bill 1422 (Bass), Chapter 157, Statutes of 2009, extended the 2.35 percent premium tax imposed on all types of insurance to include all comprehensive health plans contracting with Medi-Cal. The revenues from this tax were directed to fund health coverage for children through the Healthy Families Program, provide a cost-of-living increase to health plans participating in Healthy Families, and increase Medi-Cal capitation rates paid to health plans. Under this arrangement, 50 percent of the revenue was matched with federal funds to make health plans whole and 50 percent of the revenue was used to maintain the Healthy Families Program. This tax expired December 31, 2010, and was extended twice until it expired on June 30, 2012.

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\(^1\) Assembly Bill 1762 (Committee on Budget), Chapter 230, Statutes of 2003.
It should be noted that because the GPT is an existing tax on a broad group of insurers, the overwhelming majority of which are not health care insurers, it can be extended to Medi-Cal managed care plans without being considered a fee under federal law. As such, the state does not have to meet federal requirements for provider fees to obtain federal matching funds, using this source of revenues as the state match.

- **Current MCO Tax.** The state’s current MCO tax imposes a sales and use tax rate of 3.9375 percent on Medi-Cal managed care plans’ gross receipts effective July 1, 2013 through June 30, 2016. This tax was approved by the federal government as a component of the state’s Duals Demonstration Project (Coordinated Care Initiative). The revenues are deposited into the Childrens Health and Human Services Special Fund. Half of the MCO tax revenues are used to draw down federal Medi-Cal funds and then used to pay back Medi-Cal managed care plans in order to “make them whole”. The other half of these funds is used to offset General Fund expenditures for Medi-Cal managed care rates for children, seniors and persons with disabilities, and dual eligibles. For 2015-16, the current MCO tax is projected to generate $1.13 billion in non-federal funding for the Medi-Cal program.

**Recent Federal Guidance on Health Care Related Taxes.** On July 25, 2014 the federal Centers for Medicare and Medicaid Services (CMS) issued guidance clarifying the treatment of health care-related taxes (provider taxes) and their effect on federal matching funding for Medicaid (Medi-Cal in California) and the Children’s Health Insurance Program (CHIP). CMS clarified that provider taxes must:

- **Broad-Based** - Be broadly based, so as not to specifically target one group (must include providers that do not receive Medicaid funding).
- **Uniform** - Be uniformly imposed, meaning levied equally across all providers in that provider type.
- **No Hold Harmless** - Not hold providers harmless from the burden of the tax, meaning that states cannot guarantee taxed dollars will be returned to affected providers.

The provisions of broad-based and uniform requirements can be waived by the federal government if the tax program structure meets the standard to waive these requirements (referred to as the B1/B2 test). The hold harmless requirement cannot be waived.

States that have provider taxes that do not meet these criteria must take action in the state’s next legislative session to redesign the tax to meet these requirements. California’s current MCO tax does not meet these criteria because it is not broad-based as it applies to only Medi-Cal managed care plans and not all managed care plans in the state.

**In-Home Supportive Services (IHSS) Settlement Agreement.** As part of a 2013 settlement agreement between the Administration and labor unions and disability rights advocates regarding reductions in IHSS, the Administration is required to submit to the Legislature proposed legislation authorizing an assessment on home care services, including but not limited to home
health care and IHSS. The new assessment would be used to offset the seven percent reduction in authorized IHSS service hours, which was authorized by the 2013 settlement agreement. (This settlement agreement was in response to lawsuits regarding IHSS budget reductions in the 2009, 2010, 2011, and 2012 budgets.) This assessment proposal was supposed to be submitted to CMS by October 1, 2014.

On August 28, 2014, the Administration sent a letter to the Legislature indicating that it had worked in good-faith to develop a federally compliant proposal authorizing an assessment but, given the new federal guidance on health care related taxes, it would not be able to meet the October 1, 2014 deadline. The letter indicated that the Administration would work with all parties on viable legislation early in the 2015-16 Legislative Session.

GOVERNOR’S PROPOSAL

The Administration proposes to create a new managed care organization tax. This tax is projected to generate about $1.72 billion in revenue and offset $1.13 billion in General Fund expenditures.

The Administration cites the following goals of this proposal: (1) raise the same amount of non-federal funding for the Medi-Cal program as the current MCO tax ($1.13 billion), (2) raise an additional $215.6 million in revenues (to be matched with federal funds) to fully restore the seven percent reduction in IHSS hours, and (3) meet federal broad-based and uniform provisions and no hold harmless requirements for health care-related fees/taxes. The Administration indicates that it will likely seek federal waiver of certain broad-based and uniform requirements in order to have the lowest net financial impact on health plans.
The Administration seeks to enact this proposal by the end of March and submit the request to CMS by April 1 so that it can be implemented on July 1, 2015. See chart below for details on this proposal.

**Summary of Managed Care Organization (MCO) Tax Proposal**

### Effective Date of Tax
- July 1, 2015 – no sunset

### Who is subject to this tax?
- All full-service managed care plans regulated by the Department of Managed Care (DMHC) and the Department of Health Care Services (DHCS), except two plans that provide international coverage.
- There are about 45 plans that meet these criteria and would be subject to this tax, of which 22 are Medi-Cal managed care plans.

### How would this tax be calculated?
- The tax would be assessed based on total plan enrollment.
- Medicare (including D-SNP) and plan-to-plan (for the subcontracted plan) enrollees would be excluded from this assessment of total plan enrollment.
- It is estimated that this would apply to 277 million member months or about 23 million MCO members.
- The tax would be assessed based on a tier-structure that is intended to ensure no plan has a disproportionate tax based on its relative size and that targets the tax on plans with higher numbers of Medi-Cal enrollees.
  - Taxing Tier 1 – For enrollment up to 125,000 member months at $3.50 per enrolled member month.
  - Taxing Tier 2 – For enrollment of 125,001 through 275,000 member months at $25.25 per enrolled member month.
  - Taxing Tier 3 – For enrollment of 275,001 through 1,250,000 member months at $13.75 per enrolled member month.
  - Taxing Tier 4 – For enrollment of 1,250,001 through 2,500,000 member months at $5.50 per enrolled member month.
  - Taxing Tier 5 – For enrollment greater than 2,500,001 member months at $0.75 per enrolled member month.

### How much tax revenue would be generated by this tax and how would it be used?
- $1.72 billion in MCO tax revenue would be generated and deposited into the Health and Human Services Fund. This revenue would be used:
  - $371 million to pay Medi-Cal MCOs (matched to get an additional $371 million federal funds).
  - $215.6 million to restore the IHSS seven percent reduction (matched to get an additional $215.6 federal funds).
  - $1.13 billion in General Fund offset in the Medi-Cal program.

### Who would administer the tax?
- Either DMHC or DHCS.

### How would this tax impact MCOs?
- The Administration estimates that the net impact to MCOs, after accounting for the Medi-Cal reimbursement, is $658 million (0.48 percent of total plan revenue).
ISSUES TO CONSIDER

MCO Tax Brings Significant Funding to State. If the state does not take action to redesign its MCO tax before the end of the 2015-16 Legislative Session, it is forgoing hundreds of millions of dollars in additional federal funding for the Medi-Cal program as the revenue from the MCO tax can be used as a match for federal funding. Additionally, about $1 billion in General Fund expenditures for the Medi-Cal program are offset with the revenues from this tax. This is a significant funding source for the Medi-Cal program.

Administration Proposes Aggressive Timeline to Enact MCO Tax, Yet Important Details on the Proposal Are Not Yet Available. The Administration requests to enact this proposal by the end of March so that it can be implemented on July 1, 2015. However, at the time of this report, fiscal modelling of this proposal was not yet available. This information is critical to gaining stakeholder support.

While the Administration estimates that the net impact to MCOs is slightly less than one-half of one percent of the total aggregate revenue of plans subject to the tax, each MCO operates in a different market and may or may not be sensitive to such a proposal.

The structure proposed by the Administration and as required by federal law, results in plans with high Medi-Cal enrollment being made whole, whereas, those with little or no Medi-Cal will suffer a net loss. Under current law, California hospitals have agreed to a similar fee; however, the relative percentage of hospitals who are “losers” because they take very little or no Medi-Cal is smaller. Furthermore, the hospitals that do participate in Medi-Cal receive supplemental payment from the proceeds of the fee.

Consider Using MCO Tax Revenue to Increase Payments to Medi-Cal MCOs. The growth in Medi-Cal as a result of the federal Affordable Care Act (ACA) has made it particularly important to ensure that Medi-Cal MCO rates (for all categories, such as the ACA expansion populations and the pre-ACA caseload) are at levels necessary to ensure provider participation in the program and access to services. This is because about 80 percent of Medi-Cal enrollees are in Medi-Cal managed care.

As noted above, when the first MCO fee was first assessed, it was used to provide a rate increase to Medi-Cal managed care plans. Consequently, as part of these discussions it will be important to consider the merit of using these tax revenues to increase rates, or provide financial incentives to Medi-Cal managed care plans given their important role in the Medi-Cal.

Permanent Extension Makes Evaluation Difficult. A permanent extension of this tax would make it difficult to periodically evaluate its effectiveness and its impact on managed care plans in the state. Two of the state’s other provider fees (the skilled nursing facility quality assurance fee and the hospital quality assurance fee) have sunset dates.
Overview of the 2015-16 Budget

Health

Medi-Cal – Coordinated Care Initiative

BACKGROUND

The 2012 budget authorized the Coordinated Care Initiative\(^3\) (CCI), which expanded the number of Medi-Cal enrollees who must enroll in Medi-Cal managed care to receive their benefits. The CCI is being implemented in seven counties\(^4\) (Los Angeles, Orange\(^5\), Riverside, San Bernardino, San Diego, San Mateo, and Santa Clara).

CCI is composed of three major parts related to Medi-Cal:

- **Managed Long-Term Supports and Services (MLTSS) as a Medi-Cal Managed Care Benefit:** CCI includes the addition of MLTSS into Medi-Cal managed care. MLTSS includes nursing facility care (NF), In-Home Supportive Services (IHSS), Multipurpose Senior Services Program (MSSP), and Community Based Adult Services (CBAS). This change impacts about 600,000 Medi-Cal-only enrollees and up to 456,000 persons eligible for both Medicare and Medi-Cal who are in Cal MediConnect.

- **Cal MediConnect Program:** A three-year demonstration project for persons eligible for both Medicare and Medi-Cal (dual eligibles) to receive coordinated medical, behavioral health, long-term institutional, and home-and community-based services through a single organized delivery system (health plan). No more than 456,000 beneficiaries would be eligible for the duals demonstration in the eight counties. This demonstration project is a joint project with the federal Centers for Medicare and Medicaid Services (CMS).

- **Mandatory Enrollment of Dual Eligibles and Others into Medi-Cal Managed Care.** Most Medi-Cal beneficiaries, including dual eligibles, partial dual eligibles, and previously excluded seniors and persons with disabilities (SPDs) who are Medi-Cal only, are required to join a Medi-Cal managed care health plan to receive their Medi-Cal benefits.

The purpose and goal of CCI is to promote the coordination of health, behavioral health, and social care for Medi-Cal consumers and to create fiscal incentives for health plans to make decisions that keep their members healthy and out of institutions (given that hospital and nursing home care are more expensive than home and community-based care). See table below for enrollment summary information.

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\(^3\) Enacted in July 2012 through SB 1008 (Committee on Budget and Fiscal Review), Chapter 33, Statutes of 2012, and SB 1036 (Committee on Budget and Fiscal Review), Chapter 45, Statutes of 2012, and amended by SB 94 (Committee on Budget and Fiscal Review), Chapter 37, Statutes of 2013.

\(^4\) Alameda County was initially part of CCI but given fiscal solvency issues with one of its plans, it will not participate in CCI.

\(^5\) It is projected that Orange County will begin CCI no sooner than July 2015.
Table: Coordinated Care Initiative Enrollment Summary as of January 1, 2015

<table>
<thead>
<tr>
<th>County</th>
<th>Cal MediConnect</th>
<th>Medi-Cal-Only Managed Care for MLTSS*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Los Angeles</td>
<td>56,240</td>
<td>350,000</td>
</tr>
<tr>
<td>Orange</td>
<td>-</td>
<td>51,000</td>
</tr>
<tr>
<td>Riverside</td>
<td>14,536</td>
<td>48,000</td>
</tr>
<tr>
<td>San Bernardino</td>
<td>14,398</td>
<td>50,000</td>
</tr>
<tr>
<td>San Diego</td>
<td>19,683</td>
<td>64,000</td>
</tr>
<tr>
<td>San Mateo</td>
<td>10,226</td>
<td>14,000</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>7,825</td>
<td>31,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>122,908</strong></td>
<td><strong>608,000</strong></td>
</tr>
</tbody>
</table>

*Medi-Cal-only enrollees will receive only Medi-Cal benefits from the health plan, including MLTSS. These enrollees include full dual eligibles excluded from Cal MediConnect, partial dual eligibles, and senior and persons with disabilities.

**CCI In-Home Supportive Services (IHSS) Changes.** CCI established a county maintenance-of-effort funding formula for the IHSS program. Additionally, CCI established a Statewide Authority for purposes of collective bargaining with respect to the wages and benefits for IHSS providers in the CCI counties. The Statewide Authority for collective bargaining begins in a CCI county when enrollment into CCI is completed in the county. It is anticipated that San Mateo will transition to Statewide Authority in February 2015, followed by Los Angeles, Riverside, San Bernardino and San Diego in July 2015. Santa Clara is anticipated to transition January 2016 and finally Orange in August 2016.

**CCI Universal Assessment.** Lastly, another component of CCI was the development of a universal assessment tool (UAT) to be used to streamline the assessment process for connecting consumer to services, such as those defined as part of MLTSS. The Department of Social Services and the Department of Aging are the leads on this process. It is anticipated that the piloting of the UAT will occur in two CCI counties in 2016-17.

**GOVERNOR’S PROPOSAL**

The Governor’s budget includes a net General Fund savings of $173.8 million in 2015-16 as a result of CCI, including the General Fund savings from the sales tax on managed care organizations. Without the tax revenue, CCI would have a General Fund cost of $399 million in 2015-16. See table below for a fiscal summary.

**Factors Affecting the Fiscal Solvency of CCI.** SB 94 (Committee on Budget and Fiscal Review), Chapter 37, Statutes of 2013, requires the Department of Finance to annually determine if there are net General Fund savings for CCI. If CCI is not cost-effective, all components of CCI would cease operation. As part of the budget, the Administration identified the factors below that have occurred since the 2012 enactment of CCI that may jeopardize the fiscal solvency of this initiative. According to DOF’s current analysis, if these factors do not improve, there would be a
net General Fund cost for CCI; and consequently, CCI would cease operating effective January 2017. The Administration indicates that it remains committed to implementing CCI to the extent that it can continue to generate program savings.

The following changes have occurred since enactment of 2012 Budget Act:

- More than 100,000 participants were exempted, including Medicare Special Needs Plans and certain categories of Medi-Cal beneficiaries based on age or health condition.

- Passive enrollment was delayed until 2014, and Alameda County will no longer participate in the demonstration due to concerns regarding one of the health plan’s readiness. Orange County will not begin passive enrollment until July 2015.

- Medicare and Medicaid savings were intended to be shared 50:50 with the federal government; however, the federal government reduced the amount of savings California was allowed to retain to approximately 25 to 30 percent.

- The federal government allowed a 3.975 percent tax on managed care organizations through June 30, 2016 which is attributable to the state’s participation in the demonstration. However, recent federal guidance indicates that this tax will not be allowed to continue in its current form.

- As of November 1, 2014 approximately 69 percent of eligible participants opted out of Cal MediConnect compared to initial projections of approximately 33 percent. Of the 69 percent that have opted-out, about 80 percent of these individuals are In-Home Supportive Services (IHSS) beneficiaries.

- Due to revised federal Fair Labor Standards Act (FLSA) regulations, IHSS providers are entitled to overtime compensation. Because CCI established a maintenance-of-effort (MOE) funding formula for IHSS, the state’s IHSS fiscal exposure has significantly increased. It should be noted that since the Governor’s budget was released, a federal district court ruled that the FLSA regulations be vacated; consequently, it is unclear how this change impacts CCI.
Table: Coordinated Care Initiative Cost Savings Analysis

<table>
<thead>
<tr>
<th>Coordinated Care Initiative (CCI)</th>
<th>2014-15</th>
<th>2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local Assistance Costs/Savings Total</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payments to Managed Care Plans</td>
<td>$2,851,779</td>
<td>$5,632,869</td>
</tr>
<tr>
<td>Transfer of IHSS Costs to DHCS</td>
<td>-$723,243</td>
<td>-$1,456,769</td>
</tr>
<tr>
<td>Savings from Reduced Fee for Service Utilization</td>
<td>-$1,674,708</td>
<td>-$3,974,142</td>
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<tr>
<td><strong>Payment Deferrals Total</strong></td>
<td>-$345,729</td>
<td>-$74,443</td>
</tr>
<tr>
<td>Defer Managed Care Payment</td>
<td>-$382,473</td>
<td>-$91,688</td>
</tr>
<tr>
<td>Delay 1 Checkwrite</td>
<td>$36,744</td>
<td>$17,245</td>
</tr>
<tr>
<td><strong>Revenue Total</strong></td>
<td>-$375,061</td>
<td>-$572,871</td>
</tr>
<tr>
<td>Increased MCO Tax from CCI (All Revenue)</td>
<td>-$86,111</td>
<td>-$194,418</td>
</tr>
<tr>
<td>Increased MCO Tax from non-CCI (Incremental increase from tax rate of 2.35 to 3.93 percent as part of 2013 agreement with CMS on managed care tax)</td>
<td>-$288,950</td>
<td>-$378,453</td>
</tr>
<tr>
<td><strong>State Administrative Costs</strong></td>
<td>$34,132</td>
<td>$22,893</td>
</tr>
<tr>
<td>Department of Social Services – IHSS County MOE</td>
<td>$175,064</td>
<td>$248,593</td>
</tr>
<tr>
<td>Department of Social Services – IHSS County MOE, Costs Related to Fair Labor Standards Act</td>
<td>$62,646</td>
<td>$109,897</td>
</tr>
<tr>
<td><strong>Net Impact to State</strong></td>
<td>-$57,766</td>
<td>-$173,870</td>
</tr>
</tbody>
</table>

1) Includes administrative costs for DHCS, Department of Social Services, Department of Managed Health Care, Department of Aging, and California Department of Human Resources.

2) The IHSS county Maintenance of Effort (MOE), which changes county responsibility from a share of cost to set expenditures tied to the 2011-12 base General Fund costs. All nonfederal costs exceeding the MOE are General Fund.

**ISSUES TO CONSIDER**

**Higher Than Expected Cal MediConnect Opt-Out Rate.** The Governor’s budget warns that if certain issues are not resolved, CCI and all of its parts, would cease to operate pursuant to current law. Of the key issues cited by the Administration negatively affecting the CCI, the only issue for which the Administration has any ability to impact—without statutory changes or changes in the agreement with CMS—is the higher than expected opt-out rate for Cal MediConnect.
DHCS indicates that it is currently undertaking a study as to the demographics of those who have opted-out including trying to get a better understanding for the reasons these individuals opted-out of the demonstration. For example, DHCS is trying to assess why 80 percent of those who opted-out are IHSS beneficiaries and why there are geographical differences in the opt-out rate.

Cal MediConnect plans have committed significant financial and other resources to the success of this program. Ensuring a certain level of plan enrollment is critical not only to the success of the demonstration but potentially to the financial viability of the plans. It is essential that the Administration evaluate and address the reasons for the higher than expected opt-out rate. An essential component of this is the enrollment process as there have anecdotal reports of missing or inaccurate information.

**Real-Time Data Needed to Evaluate if CCI is Meeting Goals of Improved Care Coordination and Health Outcomes.** While, unfortunately, there were implementation issues and disruptions as CCI rolled out, many of these issues are in the process of being resolved. If CCI is to continue, it will be important for the Legislature to have the data and metrics available to evaluate if CCI is meeting its goals of improved care coordination and improved health outcomes. Regardless of the trigger language that ceases operations of CCI if there is a net General Fund impact, the Legislature should consider CCI’s overall value to the state and Medi-Cal enrollees. For example, if health outcomes are dramatically improved because health plans are aggressively using interdisciplinary care teams and providing care plan option services and there are modest increases in General Fund costs, it may be worthwhile to continue CCI.

Critical information necessary to make this evaluation include: (1) number of high risk enrollees with an individualized care plan (ICP) within 30 days after the completion of the health risk assessment (HRA), (2) low risk members with an ICP within 30 days after the completion of the HRA, (3) type and volume of care plan option services provided by health plans, (4) HRA completion rates, and (5) changes in utilization of services (e.g., change in use of long-term supports and services compared to nursing home care) and health care outcomes for both Cal MediConnect enrollees and the Medi-Cal-only enrollees.

While the Administration and the federal CMS plan to evaluate measures such as these as part of its overall evaluation of Cal MediConnect, this information is needed on a more immediate/real-time and public basis to understand if CCI is meeting its goals and how improvements can be made on a timely basis.

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6 Care Plan Options (CPO) services are optional services that a Cal MediConnect health plan may provide that are above and beyond MLTSS that could enhance a member’s care, allowing them to stay in their homes safely and preventing institutionalization. These services could vary based on the needs of the consumer and the care plan developed for this person. These CPO services may include, supplemental personal care services (above authorized IHSS), nutritional supplements and home delivered meals, home maintenance and minor home adaptation, and medical equipment.
**Evaluation Process for MLTSS Not Developed.** Most of the focus for CCI is on the component related to the duals demonstration project, Cal MediConnect. However, CCI’s component related to the integration of MLTSS into Medi-Cal Managed Care impacts over 600,000 Medi-Cal enrollees. The state has yet to develop an evaluation plan or metrics to assess how and if managed coordination of long-term supports and services is improving the health outcomes for Medi-Cal only individuals.

**Transition of MSSP to Managed Care Benefit.** One key piece of MLTSS is the transition of MSSP as services provided under a federal home- and community-based waiver into managed care benefit in the CCI counties. This transition would occur 19 months after a county enrolls MSSP beneficiaries into a managed care plan pursuant to CCI or when federal approval is received, whichever is later. For example, since Los Angeles County began enrolling MSSP beneficiaries into managed care pursuant to CCI in October 2014, the transition in Los Angeles County would occur April 2016 (or when the state received federal approval).

As part of this transition, DHCS, the Department of Aging, and the Department of Managed Health Care are required to submit a transition plan to the Legislature on how this transition would occur. The plan is required to incorporate the principles and standards of MSSP in the managed care benefit, and provisions to ensure seamless transitions and continuity of care. Managed care health plans are required, in partnership with local MSSP providers, to conduct a local stakeholder process to develop recommendations that the department is to consider when developing the transition plan. This transition planning process has not yet begun.

Although the state is about one year away from this transition, as the state learned when CBAS became a Medi-Cal managed care benefit in 2012, ensuring a smooth transition requires significant efforts to establish program standards and consensus on processes between the plans and providers. Consequently, it is important that the Administration commence this planning process in a timely manner and not rush or expedite this valuable planning process.
Department of Public Health: Licensing and Certification of Health Facilities

BACKGROUND

The California Department of Public Health’s (DPH) Licensing and Certification Program (L&C) is responsible for regulatory oversight of licensed health facilities and health care professionals to ensure safe, effective, and quality health care for all Californians. L&C fulfills this role by conducting periodic inspections and compliant investigations of health facilities to ensure that they comply with federal and state laws and regulations. L&C licenses and certifies over 7,500 health care facilities and agencies in California, such as hospitals and nursing homes, in 30 different licensure and certification categories.

The federal Centers for Medicare and Medicaid Services (CMS) contracts with L&C to evaluate facilities accepting Medicare and Medicaid (Medi-Cal in California) payments to certify that they meet federal requirements. L&C evaluates health care facilities for compliance with state and federal laws and regulations, and it contracts with Los Angeles County to license and certify health care facilities located in Los Angeles County.

L&C’s field operations are implemented through district offices, including over 1,000 positions, throughout the state, and through the contract with Los Angeles County.

In addition, L&C oversees the certification of nurse assistants, home health aides, hemodialysis technicians, and the licensing of nursing home administrators.

Long-Standing Problems with L&C. There have been long-standing concerns about the L&C program. Multiple recent legislative oversight hearings, including those conducted by Senate Budget and Fiscal Review Subcommittee No. 3, and media reports have highlighted significant gaps in state oversight of health facilities and certain professionals that work in these facilities.

These issues include:

- CMS Concerns with L&C. On June 20, 2012, the federal Centers for Medicare and Medicaid (CMS) sent a letter to DPH expressing its concern with the ability of DPH to meet many of its current Medicaid survey and certification responsibilities. In this letter, CMS states that its analysis of data and ongoing discussions with DPH officials reveal the crucial need for California to take effective leadership, management, and oversight of DPH’s regulatory organizational structure, systems, and functions to make sure DPH is able to meet all of its survey and certification responsibilities.

The letter further states that “failure to address the listed concerns and meet CMS’ expectations will require CMS to initiate one or more actions that would have a negative
effect on DPH’s ability to avail itself of federal funds.” In this letter, CMS acknowledges that the state’s fiscal situation in the last few years, and the resulting hiring freezes and furloughs, has impaired DPH’s ability to meet survey and certification responsibilities.

As a result of these concerns, CMS set benchmarks that DPH must attain and is requiring quarterly updates from DPH on its work plans and progress on meeting these benchmarks. The state was in jeopardy of losing $1 million in federal funds if certain benchmarks are not met. (Ultimately, $138,123 in federal funding was withheld.)

- **Insufficient Oversight of Los Angeles County Contract.** As discussed earlier, L&C contracts with Los Angeles County to license and certify health facilities in Los Angeles County. As revealed in March 2014, facing a backlog of hundreds of health and safety complaints about nursing homes, Los Angeles County public health officials told inspectors to close cases without fully investigating them. According to an April 21, 2014 letter from the federal CMS, the state was in jeopardy of losing federal funding if certain performance and management benchmarks regarding the L&C’s investigation of complaints and L&C’s oversight of the Los Angeles contract and are not met. (Ultimately, $251,515 in federal funding was withheld.)

- **State Auditor Concerns with L&C.** In October 2014, the State Auditor released a report regarding the L&C program. The findings from this report include:
  
  o DPH’s oversight of complaints processing is inadequate and has contributed to the large number of open complaints and entity reported incidents.

  o DPH does not have accurate data about the status of investigations into complaints against individuals.

  o DPH has not established formal policies and procedures for ensuring prompt completion of investigations of complaints related to facilities or to the individuals it certifies.

  o DPH did not consistently meet certain time frames for initiating complaints and ERIs.

- **Unable to Understand Workload and Staffing Needs.** During the 2014-15 budget subcommittee process, the Administration admitted its current methodology to assess workload demands and needs was flawed and had no proposals to increase staffing related to its workload for health facilities. As an example of the unreliability of the methodology, it estimated that it would need 70 less staff, while the prior year’s estimate indicated that L&C needed 122 more staff.

  In the past, there has been a reluctance to add L&C positions because, in addition to the flawed methodology, it has been difficult to fill Health Facility Evaluator Nurses (HFEN) positions and; consequently, these classifications had a high vacancy rate. (HFENs are registered nurses who conduct health facility surveys and respond to complaints.)
• **Credit to Health Facilities Instead of Investing in Workforce.** For each of the last two years, L&C credited health facilities with over $11 million from the special fund reserve instead of using these funds to address the problems with this program. Although L&C fees are to be used to support the work associated with enforcing state laws and requirements, DPH was resistant to using this resource to hire more staff to improve its oversight of health facilities.

**2014-15 Budget.** During last year’s budget subcommittee process, DPH indicated that it understood these concerns and was in the process of conducting a complete evaluation of its program. Prior to the completion of this evaluation, the Administration was not receptive to any additional resources to improve its health facility-licensing program.

Consequently, in an effort to provide transparency and accountability of the L&C program, the Legislature adopted trailer bill language that required L&C to:

- Report metrics, beginning October 2014 and on a quarterly basis, on: (1) investigations of complaints related to paraprofessionals certified by DPH; (2) long-term care health facility complaints, investigations, state relicensing, and federal recertification surveys; and (3) vacancy rates and hiring within L&C.

- Report by October 2016 the above information for all facility types.

- Assess the possibilities of using professional position classifications other than health facility evaluator nurses to perform licensing and certification survey or complaint workload by December 1, 2014.

- Hold semiannual meetings, beginning August 2014, for all interested stakeholders to provide feedback on improving the L&C program to ensure that Californians receive the highest quality of medical care in health facilities.

The 2014 budget also included (1) one-time funding of $1.4 million from the Internal Departmental Quality Improvement Account to conduct business process reengineering projects for its Central Applications Unit and Professional Certification Branch and contract for a project manager and consultant to facilitate and coordinate the multi-year implementation of the Hubbert System Assessment recommendations and (2) 18 two-year limited-term positions and $1,951,000 (Licensing & Certification Special Fund) to support timely investigations of allegations/complaints filed against certified nurse assistants (CNAs), home health aides (HHAs), and certified hemodialysis technicians (CHTs).

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7 SB 857 (Committee on Budget and Fiscal Review), Chapter 31, Statutes of 2014
8 In response to CMS’ concerns L&C contracted with Hubbert System Consulting for an organizational assessment of its effectiveness and performance. This assessment includes 21 recommendations for program improvement.
GOVERNOR’S PROPOSAL

The Governor’s budget includes the following requests related to the L&C program:

- **L&C Workload** - An increase of $19.8 million in 2015-16 for 173 permanent positions and 64 two-year, limited-term positions, for a total of 237 positions (123 positions will become effective July 1, 2015 and 114 positions will begin on April 1, 2016), and an increase in expenditure authority of $30.4 million in 2016-17 from the L&C Special Fund to address the licensing and certification workload. This request attempts to address the L&C’s past failures to complete its survey workload and close/completed complaint investigations. The additional staffing would be used to:

  - Reduce the number of open complaints and entity-reported incidents;
  - Decrease the average number of days to close complaint and entity-reported incident investigations;
  - Increase the percent of immediate jeopardy complaint and entity-reported incident investigations that investigated within 24 hours (those constituting an immediate jeopardy to the health or safety of a patient).

- **L&C Quality Improvement Projects** – An increase of $2 million in 2015-16 from the Internal Departmental Quality Improvement Account to implement quality improvement projects recommended by Hubbert Systems Consulting for the Licensing and Certification Program.9

- **Los Angeles County Contract** - An increase in expenditure authority of $9.5 million from the L&C Special Fund to augment the Los Angeles County contract to perform licensing and certification activities in Los Angeles County. This proposal includes $2.6 million to fully fund the current contract positions at current Los Angeles County salary rates, and $6.9 million to fund 32 additional Los Angeles County positions to enable the county to address long-term care facility complaints and entity-reported incidents, and investigate aging long-term care complaints and entity-reported incidents (Tier 1 and Tier 2 federal workload).

- **Los Angeles County Contract Monitoring** – An increase of $378,000 from the L&C Special Fund and three positions, to provide on-site oversight and perform workload management, training, and quality improvement activities to improve the efficiency and effectiveness of the Los Angeles County contract licensing and certification activities. In order to begin the on-site oversight immediately, the department plans to administratively establish three positions in 2014-15.

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9 In response to CMS’ concerns L&C contracted with Hubbert System Consulting for an organizational assessment of its effectiveness and performance. This assessment includes 21 recommendations for program improvement.
In addition, the Governor’s budget includes the following estimates in regard to L&C accounts:

<table>
<thead>
<tr>
<th>Account/Fund</th>
<th>Purpose</th>
<th>2015-16 Budget (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Health Facilities Citation Penalties Account</td>
<td>Used primarily to pay for temporary managers and/or receivers for SNFs. Funds ($1.2 million) from this account are also used to support the Department of Aging’s Long Term Care Ombudsman programs.</td>
<td>Beginning Balance: $11,272</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revenues: $2,661</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expenditures: $3,337</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fund Balance: $10,596</td>
</tr>
<tr>
<td>Federal Health Facilities Citations Penalties Account</td>
<td>Used to fund innovative facility grants to improve the quality of care and quality of life for residents of SNFs or to fund innovative efforts to increase employee recruitment or retention subject to federal approval.</td>
<td>Beginning Balance: $3,880</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revenues: $1,002</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expenditures: $937</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fund Balance: $3,909</td>
</tr>
<tr>
<td>Internal Departmental Quality Improvement Account</td>
<td>Used to fund internal L&amp;C program improvement efforts. Funded by administrative penalties on hospitals.</td>
<td>Beginning Balance: $14,654</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revenues: $3,892</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Expenditures: $2,292</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fund Balance: $16,254</td>
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</table>

By February 1, 2015, DPH is required to publish a health facility license fee report. The purpose of this annual fee report is to provide data on how the health facility licensing fees are calculated and what adjustments are proposed for the upcoming fiscal year. This report was not yet available as of February 6, 2015.

**Nurse Surveyor Vacancy Rates.** According to a December 2014 report, the HFEN vacancy rate varies from 2.5 percent to 16.67 percent in the different field offices, with an average vacancy rate of about 7.2 percent.

**ISSUES TO CONSIDER**

While the Governor’s budget represents an acknowledgement by the Administration of the long-standing problems at L&C and makes an attempt to address the inconsistent and untimely enforcement of federal and state laws regarding health facilities licensure and certification, the following issues should be considered.

**First Step, But Temporary Nature of Staffing Proposal Does Not Address Ongoing Workload.** As discussed above, the budget proposes an additional 237 positions, of which 64 would be limited-term, to address the outstanding and ongoing workload of the L&C program. Of these limited-term positions, 42 are HFENs (nurse surveyors) and seven are HFEN supervisors—the positions for which the L&C program has had the most difficult time hiring and retaining (both of these positions are registered nurses).
The state makes a significant investment in the training of HFENs and acknowledges that it takes 12 to 14 months for HFEN to complete the training necessary to become proficient and work independently. Consequently, these positions would only be available to actively complete workload for one year, since these positions are authorized for only two years. Given that L&C’s problem is not just closing a backlog of complaints, but also timely investigation and completion of new complaints and surveys and monitoring for compliance with state health facility licensing requirements (which are generally more stringent than the federal requirements), it is not clear why these positions should be limited-term. Instead, once the backlog is addressed, these trained and skilled surveyors could be directed to address other workload activities that are not the focus of this Governor’s proposal.

**Continued Oversight on Overall Plan to Improve the Program.** As discussed above, a complete assessment of the L&C program was completed in August 2014. This assessment includes 21 recommendations to allow for meaningful and measurable improvements in the program. It will be important for the Legislature to continue its oversight of the L&C program and ensure that DPH is accountable for taking the steps necessary to accomplish this major program improvement effort.

**Stronger State Oversight of Los Angeles County Contract.** The state’s contract with Los Angeles County expires June 30, 2015. DPH anticipates that contract negotiations with Los Angeles County will begin in February. As noted above, the budget proposes three positions to provide on-site monitoring of the Los Angeles County contract and an increase of $9.5 million to augment the Los Angeles County contract ($2.6 million to fully fund the current contract positions at current Los Angeles County salary rates, and $6.9 million to fund 32 additional Los Angeles County positions). It will be important for DPH to ensure that this new contract contains clear and specific performance metrics to ensure that Los Angeles County appropriately performs this workload on behalf of the state. Additionally, this new contract should include protections for the state if Los Angeles County does not meet these performance metrics.

**Significant Fund Balances Could Be Used for Long-Term Care Ombudsman Program.** Currently $1.2 million from the State Health Facility Citation Penalties Account is used to support the Department of Aging’s Long-Term Care Ombudsman Program. The Long-Term Care Ombudsman Program investigates elder abuse complaints in long-term care facilities, including skilled nursing facilities (SNFs) which are regulated by L&C.

While no data exist to prove or quantify this, it is reasonable to assume that the ombudsman program’s presence and advocacy on behalf of SNF residents improves quality of life for these residents and improves a SNF’s compliance with state and federal laws. This is because the ombudsman is often able to intervene on behalf of a resident and investigate and resolve complaints before they result in more serious and costly cases of abuse and neglect.

Consequently, in an effort to address L&C problems from another perspective, the Legislature may want to consider using L&C special funds to augment the Long-Term Care Ombudsman Program in regard to its work on facilities regulated by L&C. As noted above, there is a $10.6 million fund balance in the State Health Facilities Citation Penalties Account and a $16.2 million fund balance in the Internal Departmental Quality Improvement Account.
modest investment ($1 to $2 million) from one or both of these funds could fund significant efforts to protect the residents of these facilities.

**Outstanding Reports Will Provide Valuable Information.** The Legislature has not yet received two reports regarding the L&C program, which are critical in evaluating the L&C budget:

- A 2014 trailer bill, SB 857 (Committee on Budget and Fiscal Review), Chapter 31, Statutes of 2014, requires DPH to assess the possibilities of using professional position classifications other than Health Facility Evaluator Nurses (HFENs) to perform licensing and certification survey or complaint workload by December 1, 2014. Given the difficulty in recruiting and retaining nurse surveyors it is important to understand if certain activities performed during surveys and inspections can be carried out by other personnel classifications; thereby, improving L&C’s ability to retain quality staff and complete its workload in a timely manner.

- The annual licensing fee report is due February 1. This important report provides data on how licensing fees are calculated and what adjustments are proposed for the upcoming fiscal year. This report contains information on if the Administration is proposing to “credit” or refund fees to health facilities and can be used to identify alternative funding sources for L&C program improvement efforts.
California Work Opportunity and Responsibility to Kids

BACKGROUND

California Work Opportunities and Responsibilities to Kids (CalWORKs), the state’s version of the federal Temporary Assistance for Needy Families (TANF) program, provides cash assistance and welfare-to-work services to eligible low-income families with children. In the last several years, CalWORKs sustained significant reductions and underwent programmatic restructuring. This section will consider the impact of those program changes.

Caseload and spending trends. Prior to federal welfare reform in the mid-1990s, California’s welfare program aided more than 900,000 families. By 2000, the caseload had declined to 500,000 families. During the recent recession the caseload grew, but at an estimated 563,500 families in 2012-13, it is not anywhere close to the levels of the early 1990s. Most recently, the caseload declined 1.8 percent in 2011-12. Welfare assistance represented 6.8 percent of the state’s overall budget (including federal, state, and local resources) in 1996-97, compared with 2.9 percent in 2011-12.

Welfare-to-Work (WTW) program. Adults eligible for CalWORKs are subject to a lifetime limit of 48 months of assistance. Unless exempt for reasons such as disability or caregiving for an ill family member, adults must participate in work and other welfare-to-work (e.g., educational) activities. Depending on family composition, these activities are required for 20, 30, or 35 hours per week. The program also offers supportive services, such as childcare and housing support. Effective January 1, 2013, clients are under the WTW 24-month clock, which provides 24 months of additional flexibility around how to meet work requirements, but then after the initial 24-months, imposes stricter work requirements to receive assistance and a limit on the number who can.

CalWORKs child care. CalWORKs participants are eligible for child care if they are employed or participating in WTW activities. CalWORKs child care is administered in three stages:

- Stage 1. Provides care to CalWORKs families when first engaged in work or WTW activities, and is provided by the Department of Social Services (DSS).

At a Glance: CalWORKs

- Around three-quarters of all CalWORKs recipients are children.
- 92% of heads of CalWORKs household are women, where two-thirds are single and have never married.
- The budget assumes a caseload of 533,335 families.
- Total CalWORKs expenditures have remained relatively flat (around a five percent increase -- $5.3 billion in 2008-09 and $5.6 billion in Governor’s Budget) despite significantly higher caseload growth during the Great Recession.
Overview of the 2015-16 Budget Human Services

- **Stage 2.** Once counties deem the family “stable,” CalWORKs families move to this program. Families remain in Stage 2 until they have not received assistance for two years. The California Department of Education (CDE) administers this program.

- **Stage 3.** Families transition to this program after Stage 2. CDE also administers this program.

Stages 1 and 2’s services are considered entitlements, whereas Stage 3’s services are available based on funding levels. Families receiving CalWORKs assistance, those considered “safety net,” or families who are sanctioned are not required to pay family fees. For more information about CalWORKs child care, please see the Early Care and Childhood Education section.

**Major program changes.** SB 1041 (Budget and Fiscal Review Committee), Chapter 47, Statutes of 2012, made significant changes to CalWORKs’ welfare-to-work rules, including:

- Creation of a 24-month time limit with more flexible welfare-to-work activities before the time limit has been reached and stricter requirements afterward (up to 48 total months).

- A two-year phase-out of temporary exemptions from welfare-to-work requirements for parents of one child from 12 to 24 months old or 2 or more children under age 6, along with a new, once in a lifetime exemption for parents with children under 24 months.

- Changes to conform state law to the number of hours of work participation (20, 30, or 35, depending on family composition) required to comply with federal work requirements.

Counties may provide extensions of the more flexible rules for up to six months for up to 20 percent of participants. This 20 percent extender is not a cap, but a target. By the end of the budget year, DSS estimates that 12,456 cases may reach the end of the 24-month clock, with an estimated 7,934 cases experiencing a grant reduction by June.

**Early engagement.** SB 1041 required DSS to convene stakeholder workgroups to inform the implementation of the above changes, as well three strategies intended to help recipients engage with the WTW component, particularly given the new time limits and rule changes, specifically:

1. **Expansion of subsidized employment.** Under subsidized employment, counties form partnerships with employers, non-profits, and public agencies. Wages are fully or partially subsidized.

2. **Family stabilization.** Family stabilization (FS) is intended to increase client success during the flexible WTW 24-Month Time Clock period by ensuring a basic level of stability for clients who are especially in crisis, including: intensive case management and barrier removal services. Clients must have a “Stabilization Plan” with no minimum

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1 In the first 24 months, the flexible activities could include: employment, vocational education; job search; job readiness; job skills training; adult basic education; secondary school; or barrier removal activities.
hourly participation requirements. Six months of clock-stopping is available, if good cause is determined.

3. **Online CalWORKs Appraisal Tool (OCAT).** OCAT is a standardized statewide WTW appraisal tool that provides an in-depth assessment of a client’s strengths and barriers, including: employment history, interests, and skills; educational history; housing status and stability; language barriers; child health and well-being; and, physical and behavioral health, including, but not limited to, mental health and substance abuse issues. The department estimated that OCAT would be available statewide September 2014 but roll-out has been delayed. OCAT will reach all counties by the end of 2015.

**Monitoring results and outcomes.** RAND Corporation will evaluate the enacted changes and provide the Legislature a report by October 1, 2017. In the interim, the Department of Social Services (DSS) must annually update the Legislature regarding implementation of the enacted changes.
Work participation rate. TANF requires states to meet a work participation rate (WPR) for all aided families, or face a penalty of a portion of their block grant. States can, however, reduce or eliminate penalties by disputing them, demonstrating reasonable cause or extraordinary circumstances, or planning for corrective compliance. However, the federal formula for calculating a state’s WPR has been the subject of much criticism. For example, it does not give credit for a significant number of families who are partially, but not fully, meeting hourly requirements. California did not meet its federal WPR requirements for 2007, 2008, or 2009. The state is appealing penalties of $47.7 million and $113 million for 2008 and 2009. California did
meet federal requirements for the two-parent WPR. In addition, the Work Incentive Nutritional Supplement (WINS) program, which provides a state-funded benefit of $10 monthly to families receiving CalFresh who are meeting TANF work requirement, began on January 1, 2014. It is expected to help improve the state’s WPR because those state funds will be counted toward the state’s TANF Maintenance of Effort (MOE) requirement and because the beneficiary families count in the state’s WPR.

Recent budget actions. Last year, SB 855 (Budget and Fiscal Review), Chapter 29, Statutes of 2014, enacted several changes to the program, including:

- **Eligibility for individuals with previous felony drug convictions.** This policy, which expands eligibility for adults who were previously ineligible for benefits due to a prior felony drug conviction, implements on April 1, 2015. The department estimates that approximately 400 persons with a prior felony drug conviction will be added to an existing CalFresh household, and approximately 1,100 households will become newly eligible for CalFresh. In addition, DSS estimates that around 3,900 CalWORKs child-only cases per month are anticipated to include an adult with a previous felony drug conviction that will become eligible for CalWORKs. The 2015-16 budget provides $23.4 million ($1 million General Fund) for this policy.

- **Establish the CalWORKs Housing Support Program.** $20 million ($12 million General Fund) was awarded to 20 counties to provide evidence-based interventions to families receiving CalWORKs who are at risk for homeless or are homeless. Services could include landlord outreach, housing search and placement, legal services, and housing barrier assessment.

GOVERNOR’S PROPOSAL

There is no major programmatic or funding change to CalWORKs as outlined in the Governor’s budget. The budget includes $5.6 billion in federal, state, and local funds for the program, and estimates an average monthly caseload of 533,000 families. The budget reflects full year cost ($174.6 million) of the five-percent restoration to the Maximum Aid Payment (MAP) grant levels, effective April 1, 2015. These costs will be funded by 1991 Realignment growth funds in the Child Poverty and Family Supplemental Support Subaccount ($101.3 million) and a $73.3 million General Fund augmentation. Future grant increases will be based on subsequent revenue analysis and caseload estimates.

ISSUES TO CONSIDER

**Impacts of recent reductions and program restructuring.** The CalWORKs program sustained a volume of grant reductions and program restructuring—such as reduced time limits and different work participation rules—in a time of significantly high caseloads during the Great Recession. In the last two years, two MAP restorations have been approved and will go into effect. As the economy recovers, the Legislature may wish to review how the CalWORKs
Restructure, which occurred during a period of economic distress, has impacted client outcomes, and to consider opportunities for future refinement.

- **Have recipients received early engagement strategies?** Some early engagement activities, such as the Online CalWORKs Appraisal Tool, have taken months to develop, pilot test, and implement into county systems while recipients’ 24-hour clocks have been ticking. Because of the phase-in nature of the early engagement strategies, clients will have had varying levels of exposure to the activities. Is it appropriate that some clients will have had the benefit of a new appraisal tool that identifies barriers while other recipients have not? How have counties used family stabilization funds? How many subsidized employment placements have led to long-term, living-wage employment? Given the breadth of new early engagement tools, revised time limits, and changes in work participation requirements, the Legislature may wish to review the implementation of early engagement, and determine if it appropriate that some clients’ 24-month clocks will have possibly expired without full access to these tools.

- **Has the utilization of supportive services, like child care, increased?** As more work-eligible individuals participate in re-engagement and re-enter the workforce, there should be a corresponding increase in child care. However, we have not seen a significant impact driving utilization for any of CalWORKs child care stages. Instead, there has been decrease in Stage 1 and 2 slots from 2012-13 to 2013-14, with only slight upticks in Stages 1 and 3 in the last two years. The Legislature may wish to investigate why the utilization of supportive services appears to not have significantly increased.

- **Has there been an anticipated increase in participation for education-related activities?** Under the 24-month clock, the state removed the “core” and “non-core” distinction in activities, assuming an increased participation in non-core activities during the flexible 24-month clock (e.g., vocational training, mental health treatment, or adult education). Also, as related to the 24-month clock, we might have anticipated an increase in the number of enrollments at community colleges, given the new flexibility for educational pursuits. Instead, we find that the number of clients receiving CalWORKs who are also participating in community colleges decreased by fourteen percent in the last three years. Further, the department indicates that current data is unable to identify which activities a client participated in during their 24-month clock. This inability to longitudinally track activity pre-dates the establishment of the 24-month clock.

- **Is there a decrease in the number of sanctions?** Over the past 12 years, the number of sanctions has ranged from a low of about 38,000 individuals in November 2007 to a high of about 63,000 individuals in July 2014. Determining the cause, or causes, of a sanction rate is complex. One factor could be the gradual phase-out of the short-term young child exemption. Another could be changes in county administrative behavior, or changes in how individuals interact with their WTW plan. In addition, several recent policy changes, such as reengagement, the 24-month time clock, and early engagement, might influence

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2 Re-engagement refers to the process by which DSS re-engaged parents in approximately 15,000 families whose young-child exemptions ended over the last two years.
3 “Core” activities mean that they can count toward any hours of work participation for an individual.
the number of sanctions. It remains unclear what factors contribute to the significant increases in the sanction rate. Given the additional flexibility of the 24-month clock, the increase in sanctions is somewhat unexpected. The Legislature may wish to a) identify factors, like the 24-month clock, associated with and contributing to the increase number of sanctions; and b) employ strategies to reduce the number of sanctioned cases.

**Evaluating the “work first” approach.** The Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA, P.L. 104-193), signed on August 22, 1996, reshaped food and assistance programs, emphasizing a “work first” approach to welfare reform. Nearly twenty years after welfare reform, the Legislature may wish to evaluate whether the existing “work-first” approach successfully removes barriers and provides long-term, positive outcomes for recipients; or, if additional discussion regarding alternative approaches that include the blending of services, supports, and investment in human capital (e.g., skills based training, education) may also create long-term, high-wage employment and mobility out of poverty.

**Other policy considerations.** The Legislature may also be considering:

- **Maximum family grant (MFG)** stipulates that a family’s maximum aid payment will not be increased for any child born into a family that has received CalWORKs for ten months prior to the birth of a child. There is proposed legislation in the current session seeking to amend the MFG.

- **Earned income disregard.** Since 1997, CalWORKs has allowed families to keep the first $225 of their pre-tax earnings, without an impact on reducing the CalWORKs grant amount. This amount has not been increase since it was cut and then restored.

**Tackling poverty.** In 2011, the U.S. Census Bureau and the Bureau of Labor Statistics released its estimates of poverty based on the Supplemental Poverty Measure (SPM), which takes into account the effects of government programs designed to assist low-income families, including refundable tax credits and other in-kind public benefit programs, like Supplemental Nutrition Assistance Program (SNAP); necessary expenses that may affect family resources, such as commuting costs, out-of-pocket medical expenses, and childcare costs; and, geographic differences in housing costs. According to the 2011 U.S. Census Bureau figure, California’s current official poverty measure is 16.5 percent; under the SPM, its poverty rate over 2009-2011 averaged 23.8 percent – the highest of any state in the nation.

Poverty rates vary significantly across California’s counties. In 2011, San Mateo County had the lowest poverty rate (7.2 percent), and Merced County had the highest (30 percent). Around 30 percent of all poor people in California lived in Los Angeles County (1.8 million people) in 2011. The table below shows the poverty rates across counties. The Legislature may wish to

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discuss how the CalWORKs program, including strategies for subsidized employment, interacts with families in deep poverty.

**Poverty rates vary widely across California’s counties**

<table>
<thead>
<tr>
<th>County or county group</th>
<th>Poverty rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merced</td>
<td>32.0</td>
</tr>
<tr>
<td>Tulare</td>
<td>27.3</td>
</tr>
<tr>
<td>Imperial</td>
<td>24.4</td>
</tr>
<tr>
<td>Fresno</td>
<td>22.8</td>
</tr>
<tr>
<td>Kern</td>
<td>22.3</td>
</tr>
<tr>
<td>Stanislaus</td>
<td>21.0</td>
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<tr>
<td>Madera</td>
<td>21.5</td>
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<tr>
<td>Del Norte, Lassen, Modoc, Siskiyou</td>
<td>21.5</td>
</tr>
<tr>
<td>Yolo</td>
<td>21.0</td>
</tr>
<tr>
<td>Lake, Mendocino</td>
<td>19.6</td>
</tr>
<tr>
<td>Butte</td>
<td>19.9</td>
</tr>
<tr>
<td>Humboldt</td>
<td>19.4</td>
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<tr>
<td>Shasta</td>
<td>18.6</td>
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<tr>
<td>Kings</td>
<td>18.4</td>
</tr>
<tr>
<td>Contra Costa, Glenn, Tehama, Trinity</td>
<td>16.8</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>18.6</td>
</tr>
<tr>
<td>San Bernardino</td>
<td>18.3</td>
</tr>
<tr>
<td>San Joaquin</td>
<td>17.7</td>
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<tr>
<td>Sacramento</td>
<td>16.2</td>
</tr>
<tr>
<td>Monterey, San Benito</td>
<td>16.1</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>County or county group</th>
<th>Poverty rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>San Luis Obispo</td>
<td>16.1</td>
</tr>
<tr>
<td>Butte, Yuba</td>
<td>15.7</td>
</tr>
<tr>
<td>San Diego</td>
<td>15.2</td>
</tr>
<tr>
<td>Santa Barbara</td>
<td>14.4</td>
</tr>
<tr>
<td>San Mateo</td>
<td>14.0</td>
</tr>
<tr>
<td>Alameda, Amador, Calaveras, Kyo, Mendocino, Modoc, Siskiyou</td>
<td>13.9</td>
</tr>
<tr>
<td>Colusa</td>
<td>13.8</td>
</tr>
<tr>
<td>Napa</td>
<td>13.3</td>
</tr>
<tr>
<td>San Francisco</td>
<td>13.0</td>
</tr>
<tr>
<td>Orange</td>
<td>12.1</td>
</tr>
<tr>
<td>Norwalk</td>
<td>12.0</td>
</tr>
<tr>
<td>Contra Costa, Glenn, Tehama, Trinity</td>
<td>12.0</td>
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<td>Siskiyou</td>
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<tr>
<td>Ventura</td>
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<td>Santa Clara</td>
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<td>Marin</td>
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<tr>
<td>Placer</td>
<td>8.4</td>
</tr>
<tr>
<td>San Mateo</td>
<td>7.2</td>
</tr>
</tbody>
</table>

*Sources: American Community Survey, 2011. Notes: For some counties, poverty rates cannot be calculated individually and are thus grouped with nearby counties. From: Just the Facts: Poverty in California, PPIC, 2013.*

**What would grant levels have been?** In 1996-97, a maximum grant for a family of 3 was $594, or 55 percent of federal poverty level (FPL). By comparison, in 2015-16, a maximum grant for a family of three is projected to be $704 or 42 percent of FPL. Had the maximum grant levels remained at 55 percent of FPL (using 1996-97 as the base year), the 2015-16 maximum grant level would be $920. Using 1996-97 as the base year, if grants had received no cuts or increases in the intervening years and received previously applicable cost-of-living adjustments (COLAs), the 2015-16 maximum grant level would be $1,050 or 63 percent of FPL.
Child Welfare Services: Continuum of Care Reform

BACKGROUND

California’s child welfare system seeks to prevent, identify, and respond to allegations of child abuse and neglect. Families who are in the child welfare system receive services so children can remain safely in their homes, and/or children who are temporarily removed from their homes can reunify with their families. In instances when reunification is not possible, permanency may occur through adoption or guardianship.

The core of child welfare services (CWS) is made up of four components:

- **Emergency Response:** Investigations of cases where there is sufficient evidence to suspect that a child is being abused or neglected.
- **Family Maintenance:** A child remains in the home, and social workers provide services to prevent or remedy abuse or neglect.
- **Family Reunification:** A child is placed in foster care, and services are provided to the family with the goal of ultimately returning the child to the home.
- **Other Placements:** provides permanency services to a child who is unable to return home and offers an alternative family structure, such as legal guardianship or independent living.

Temporary placement types. There are three major temporary placement types — a foster family home (FFH), foster family agency (FFA), or group home:

- Foster family homes (FFHs) are licensed residences that provide for care up to six children.
- Foster family agencies (FFAs) are private, nonprofit corporations intended to provide treatment and certify placement homes for children with higher level treatment needs.
- Lastly, group homes (GH) are licensed to provide 24-hour non-medical residential care in a group setting to foster youth from both the dependency and delinquency jurisdictions.

Placement costs. Group home placements constitute 13 percent

At a Glance: Child Welfare

- As of July 1, 2014, there are approximately 60,000 children in out-of-home care, served by child welfare agencies or juvenile probation.
- The statewide median length of time in care, from date of removal to date of reunification, was 8.7 months. The national goal is 5.4 months.
- Of all children entering care in the 6-month period who were still in foster care at selected time frames after entry around 37% of are in their second placement.
- 6,485, or 11.5% of the children in child welfare supervised foster care, are authorized for psychotropic medication.
- According to the National Center on Youth Law, 56.3% of foster children living in group homes are on one or more psychotropic medications
- In 2012, DSS reports there were 4,621 probation-supervised foster youth, with more than 1,200 of them residing in Los Angeles County.
of foster care placement and represent nearly 46 percent of total foster care costs. Group home rates are based on the level of care and services provided, ranging from $2,332 to $9,879 per month.

Table 1: 2015-16 Governor’s Budget: Average Monthly Grants

<table>
<thead>
<tr>
<th>Service Type</th>
<th>Average Monthly Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group Home</td>
<td>$8,300</td>
</tr>
<tr>
<td>Foster Family Agency¹</td>
<td>$2,075</td>
</tr>
<tr>
<td>Adoption Assistance</td>
<td>$972</td>
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<tr>
<td>Foster Family Home</td>
<td>$916</td>
</tr>
<tr>
<td>Federal Guardian Assistance</td>
<td>$790</td>
</tr>
<tr>
<td>Kinship Guardian Assistance</td>
<td>$751</td>
</tr>
</tbody>
</table>

Group home facilities are organized under a system of rate classification levels (RCLs) ranging from 1-14 that are based on levels of staff training and ratios. In practice, a majority of group homes are RCL 10 and above, with nearly 50 percent of group homes at RCL 12. The SB 1041 (Committee on Budget and Fiscal Review), Chapter 47, Statutes of 2012, made permanent a moratorium on applications for any of the following: a new program, a new provider, a program change, such as a Rate Classification Level (RCL) increase, a program capacity increase, and a program reinstatement; and provided specified exceptions to the group home moratorium on group home applications and rate changes.

Duration in placement. According to the department’s CWS Realignment Report, for the largest age group category, 13-17 years old, of the 4,737 children, the majority (45 percent) move out of group home placements in less than 12 months, longer stays (12-36 or more months) comprise the remaining 55 percent (2,619). From 2009 to 2013, the total number of children and youth placed in group homes for the same population dropped from 7,033 to 6,188. DSS estimates that around 3,000 children and youth are in group homes for more than one year; of these, 1,000 have been in group home for more than five years.

Licensing and regulations. The Community Care Licensing Division licenses facilities, including foster family homes, foster family agencies (who, in turn, certify individual foster families), and group homes. All facilities must meet minimum licensing standards, as specified in California’s Health and Safety Code and Title 22 Regulations. Among those requirements, group homes must provide youth with direct care and supervision, daily planned activities, food, shelter, transportation to medical appointments and school, and at least a monthly consultation and assessment by the group home’s social worker and mental health professional if necessary, for each child. Ultimately, DSS must visit all facilities at least once every five years, which is less frequent than required in most states. In addition, there is a “trigger” by which annually required inspections increase if citations increase by 10 percent from one year to the next. The Governor’s budget includes $3 million General Fund and staff to address a backlog of complaint cases and to expand training and technical assistance. The budget also provides a plan for how CCL intends to increase inspection frequency over three years.

¹ Includes four components: the basic rate, the child increment (both for care and supervision), the administration rate, and the social worker rate.
Realignment. In 2011, Governor Brown and the Legislature realigned several programs, including child welfare and foster care, and shifted program and fiscal responsibility for non-federal costs to California’s 58 counties. General Fund, which was formerly provided to the counties for child welfare and probation, has been realigned to counties as a revenue stream in the form of a portion of the state’s sales tax. The state retains child welfare oversight and serves as the agency for federal funding and administration. Counties must meet all state and federal mandates in CWS and Probation.

Recent policy and budget actions. Several policies and budget actions lay the groundwork for child welfare reform, including:

- **Extended foster care.** AB 12 (Beall), Chapter 559, Statutes of 2010, enacted the “California Fostering Connections to Success Act of 2010,” which provides an extension for foster youth, under specified circumstance, to remain in care until age 21; increases support for kinship care (opportunities for youth to live with family members); improves education stability; coordinated health care services; provides direct child welfare; and, expands federal resources to train caregivers, child welfare staff, attorneys, and more.

- **Katie A.** The *Katie A. vs. Bonta* case was first filed on July 18, 2002, as a class action suit on behalf of children, who were not given adequate services by both the child protective system and the mental health system in California. The suit sought to improve the provision of mental health and supportive services for children and youth in, or at imminent risk of placement in, foster care in California. The California Department of Social Services and Department of Health Care Services worked together with the federal court appointed Special Master, the plaintiffs’ counsel, and other stakeholders to develop and implement a plan to accomplish the terms of the settlement agreement. On December 1, 2014, court jurisdiction over the *Katie A.* lawsuit expired. Outcomes from the settlement agreement and implementation plan include the creation of the Core Practice Model was created; and the provision of Intensive Care Coordination, Intensive Home Based Services, and Therapeutic Foster Care to eligible children. Both DSS and DHCS will continue to support, assist, and guide county child welfare and mental health agencies as they continue to build their infrastructures and increase service delivery.

- **Title IV-E Waiver.** Title IV-E is the major federal funding source for child welfare and related probation services. These funds, which were previously restricted to pay for board-and-care costs and child welfare administration, can be used to provide direct services and supports under the waiver extension. Since Title IV-E funding is based solely on actual cost of care, if a county’s preventative services are effective and fewer children enter or stay in the foster care system, the county’s Title IV-E funding is reduced. Thus, the county is penalized for reducing foster care placements, even though such a reduction is the most desirable outcome. Last year’s budget authorized the waiver

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2 AB 118, (Budget Committee), Chapter 40, Statutes of 2011, and AB 16x1 (Budget Committee), Chapter 13, Statutes of 2011, realigns funding for Adoption Services, Foster Care, Child Welfare Services, and Adult Protective Services, and programs from the state to local governments and redirects specified tax revenues to fund this effort.
extension for five years, beginning October 1, 2014. The seven participating counties include: Alameda, Butte, Lake, Los Angeles, Sacramento, San Diego, San Francisco, Santa Clara, and Sonoma.

- **Commercial Sexual Exploitation of Children Program.** SB 855 (Budget and Fiscal Review Committee), Chapter 29, Statutes of 2014 provided $5 million, and $14 million General Fund ongoing, to enable county child welfare agencies to provide services to child victims of commercial sexual exploitation to enable county child welfare agencies to serve victims of commercial sexual exploitation.

- **Relative Caregiver Funding.** Effective January 1, 2015, counties, who opt-in to the Approved Relative Caregiver Funding Program, must pay an approved relative caregiver a per child, per month rate, in return for the care and supervision of a federally ineligible Aid to Families with Dependent Children-Foster Care (AFDC-FC) child placed with the relative caregiver, equal to the base rate paid to foster care providers for a federally-eligible AFDC-FC child. The 2014-15 budget provided $30 million for this program.

**Continuum of Care Reform Report.** SB 1013 (Budget and Fiscal Review Committee), Chapter 35, Statutes of 2012, authorized the Continuum of Care Reform (CCR) effort to develop recommendations related to the state’s current rate setting system, and to services and programs that serve children and families in the continuum of Aid to Families with Dependent Children-Foster Care (AFDC-FC) eligible placement settings. In particular, the Legislature expressed its intent for recommended reforms, including reforms related to the use of group homes, changes to the rate systems, and changes to the assessment of children’s needs, and to outcome measurement, to promote positive outcomes for children and families.

On January 9, DSS released the report concurrently with the release of the Governor’s budget. The report provided 19 recommendations with the expressed goal to:

Reduce reliance on group homes as a long-term placement setting by narrowly defining the purpose of group care, and by increasing the capacity of home-based family care to better address the individual needs of all children, youth, and caregivers.

According to the department, the recommendations “represent a paradigm shift from traditional group homes as a long-term placement to Short-Term Residential Treatment Centers (STRTC) as an intervention.” The list of 19 recommendation seek to improvement assessment of child and families to make more appropriate initial placement decisions; emphasize home-based family care; support placement with available services; change the goals for group home care placement; and, increase transparency for child outcomes. Some of the recommendations include:

- **Accreditation.** Require STRTCs and Foster Family Agencies to be accredited by a national body, as a condition of receiving a foster care rate.

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• Foster Family Agencies (FFA). Allow public agencies to be licensed to operate an FFA. Strengthen resource family recruitment (such as relative caregivers and foster and adoptive families), training, and retention strategies.

• Short Term Residential Treatment Centers (STRTCs). STRTC programs will provide services and support for children and youth who need short-term, intensive treatment. Placements must be reviewed at six-month intervals or less.

• Rate structures. Replace the group home Rate Classification Level system with a statewide residential rate for all STRTCs. Revise the FFA rate structure to account for two types of FFAs – those that provide core services, and those that function as home-finding agencies.

• Residential treatment. Phase-out county-operated children’s shelters. Educationally-based boarding schools for foster youth must adapt and align their programs to meet CCR goals.

• Performance and outcomes. Use a client satisfaction survey to capture children and their families’ perceptions regarding services received from STRTC and FFA treatment providers. Develop a method to increase transparency of a provider’s performance.

GOVERNOR’S 2014-15 BUDGET PROPOSALS

The budget includes $9.6 million ($7 million General Fund) to fund two of the 19 recommendations outlined in the Continuum of Care Reform Report: increase foster parent recruitment, retention, and training efforts; and to increase foster family agency social worker rates.

ISSUES TO CONSIDER

Poor outcomes associated with group homes. Most children served by a child welfare agency are placed with families. However, approximately 3,000 children and youth have been in group homes for more than one year, and probation departments often use group home settings in lieu of locked settings. Significant research documents the poor outcomes of children and youth in group homes. For example, children who leave group care to reunification have higher re-entry rates into foster care. In addition, students in group homes were the least likely to graduate (35 percent), whereas students in kinship (64 percent) and guardianship placements (71 percent) were the most like of 12th grade students in foster care to graduate from high school. Further, group home placement is also associated with increased risk of arrest. While some youth residing in group homes may have already had more complex needs at the time of their placement, research also indicates that congregate care settings themselves, and the long-term use of residential shift care instead of family-based settings, may create or exacerbate their challenges.

Post-Katie A. As discussed above, the Katie A. lawsuit found that foster youth who met the medical necessity criteria for Specialty Mental Health Services or Early Periodic Screening Diagnosis and Treatment (EPSDT) were not receiving their entitled mental health benefits. EPSDT, a Medi-Cal benefit, was realigned. As a result, county mental health departments, which administer EPSDT mental health services, have expressed concerns that increases in services provided to foster youth under Katie A. may not be adequately funded. Foster youth advocates
note that EPSDT services under Medi-Cal are an entitlement benefit that foster youth had been unfairly excluded from receiving. Now that the court jurisdiction for *Katie A.* has expired, the Legislature may wish to consider how CCR efforts will ensure that mental health services follow the child, regardless of placement type.

**Prescription of psychotropic medication.** According to the National Center on Youth Law, the rate at which teenagers in California group homes are prescribed psychotropic drugs has risen from near zero in 1999 to more than 55 percent in 2011. Studies have shown that age, gender, and placement type impacts the prevalence of psychotropic drug use.\(^4\) According to the U.S. Department of Health and Human Services – Administration on Youth and Families (ACF), children in foster care are more likely to be prescribed psychotropic medications as they grow older, with 3.6 percent of two to five year-olds taking psychotropic medication at a given time. This increases to 16.4 percent of 6-11 year olds and 21.6 percent of 12-16 year olds. The likelihood that a child will be prescribed multiple psychotropic medications also increases with age. In addition, males in foster care are more likely to be receiving psychotropic medications (19.6 percent) than their female counterparts (7.7 percent). Pertaining to placement type, ACF finds that children in the most restrictive placement setting are the most likely to receive psychotropic medications, or multiple medications. In group or residential homes, nearly half of the young people are taking at least one psychotropic drug. Advocates raise concerns that psychotropic drugs are often being administered for non-medical reasons: as chemical restraints, for the convenience of caretakers, and as punishments for being unpleasant or troublesome.

In 2012, the Department of Health Care Services and Department of Social Services initiated a collaborative called the Foster Care Quality Improvement (“QI”) project for psychotropic drugs in foster care. Workgroups included data management, family and education, and clinical concerns. The workgroups until continue until March 2015, with deliverables to include a universal data sharing agreement between DSS, DHCS, and counties; and, new data measures to track the outcomes of youth in foster care who received a paid claim for psychotropic medication, such as use of multiple concurrent psychotropic medication and follow-up visits with a physician. The Legislature may wish to continue its oversight role and identify whether additional systemic changes are needed.

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\(^5\) Administration for Children and Families Information Memo: “Promoting the Safe, Appropriate, and Effective Use of Psychotropic Medication for Children in Foster Care (2012).”

SUBCOMMITTEE NO. 4

STATE ADMINISTRATION and GENERAL GOVERNMENT

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Department of Technology: Modifying Project Management

BACKGROUND

The State of California has had a number of challenges delivering on-time and on-budget information technology (IT) projects. Several high-profile projects have experienced significant revisions, delays, and cost overruns. The numerous setbacks have been the topic of several legislative oversight hearings, and have led to organizational and process changes within the Administration. One of the more significant changes was the Legislature’s approval of a statewide project management office within the Department of Technology (CalTech).

2.0 positions and $208,000 (General Fund) were approved as part of the 2014-15 Budget Act to begin the process of creating a statewide project management office at CalTech. The approved positions will assist CalTech in creating a framework for the statewide project management office, developing guidelines, and possibly identifying projects that may require assistance in the near future. The Department of Finance has committed to working closely with CalTech to further determine the requirements that may be needed to fully implement a statewide project management office. In order to better ensure the successful delivery of IT projects many issues will need to be addressed in the near future.

The Senate Budget and Fiscal Review Subcommittee No. 4 (subcommittee) has conducted an extensive review of the state’s IT procurement and project implementation process. The subcommittee’s review began with the procurement and project implementation of the State Controller’s 21st Century Project. The 21st Century Project, which was intended to unify an automated statewide payroll disbursement system, was originally estimated to cost $84 million. Prior to its suspension in 2013, overall project costs were estimated to be over $300 million. Over the project’s nine-year lifespan the project costs ballooned by over 350 percent.

While the attention of the subcommittee was originally focused on the 21st Century Project, there were several other high-profile IT projects that were also experiencing difficulty. For example, the California Department of Motor Vehicles’ (DMV) $200 million IT modernization project also was suspended in 2013. Upon learning of the suspension of the DMV’s IT modernization project, the subcommittee questioned whether or not there was an underlying issue that has handicapped the state’s ability to deliver an IT project on time and on budget. The subcommittee came to a conclusion that was similar to the Administration’s. The individuals tasked with implementing an IT project often lack the experience necessary to successfully deliver complex IT projects. Furthermore, the subcommittee found the short-term nature of an IT project results in a significant amount of resources being dedicated to a department that may not see another IT project for a decade.
Centralized vs. Decentralized Approach. Historically, the state has relied on tasking individuals within a department to manage project IT implementation. In concept, this approach, which is referred to as a decentralized approach, utilizes the individual that best understand the business needs of the department that will deliver the IT project. The oversight of day-to-day project implementation activities are often left to the department. Under the decentralized approach, project management staff are expected to learn project methodologies and create a team to support the project implementation process. This approach often relies heavily on vendor support to assist with the project implementation process.

One of the primary challenges of utilizing a decentralized project management approach is the lack of experienced project management staff at the department level. Many project managers are starting from scratch; they lack experienced team members, structure, and have a limited understanding of project methodologies. Lessons learned from one project to the next are infrequently shared, and training is applied at varying levels.

To address this, CalTech proposed moving from a decentralized approach to a centralized approach through the creation of a statewide project management office. This office would be responsible for the management of an IT project from the beginning to final deployment. CalTech eventually intends consolidate much of the state’s project management effort to one centralized location, where information sharing is more feasible, training can be applied in a more uniform fashion, and the personnel utilized for project management are experienced professionals that are capable of managing more complex projects.

Currently, the state utilizes a centralized project implementation process in the health and human services sector. CalTech has expressed an interest in modeling their services after the Office of Systems Integration (OSI), which is housed within the Health and Human Services Agency (HHSA). OSI was established by SB 68 (Senate Budget and Fiscal Review) Chapter 78, Statutes of 2005. The departments currently served by OSI include; the Health and Human Services Agency, the Department of Social Services, the Health Benefit Exchange, and the Employment Development Department. Some of the projects managed by OSI include the state’s automated welfare system, a case management payroll system, an electronic benefits transfer project, and a child welfare services case management system.

Many states have transitioned to a centralized IT project management process. The Center for Digital Government surveyed states to evaluate which best utilize technology to serve its citizens. A consistent theme found among the states that scored the highest marks was the use of a centralized IT organization. Utah, which consistently ranks at the top of the list, cited the state’s project management process as one of the key reasons for its success. Utah consolidated their IT organization in 2005, pooling all IT resources into one central agency, and now leads the nation in online vehicle registrations, with 2.5 million registrations annually.

Michigan has consolidated their IT efforts into one centralized agency and have been recognized by the Center for Digital Government’s annual survey. Michigan recently launched a Medicaid compliance program, on time and on budget, which it estimates will have over 400,000 unique enrollees, on time and on budget. Michigan’s state CIO, David Behe, attributed the successful
launch of this program to the greater level of accountability that can be applied to the organization.

**ISSUES TO CONSIDER**

The 2014-15 state budget provided OSI with $247 million (special fund) and 210 personnel. However, OSI manages a much smaller IT project portfolio than CalTech, totaling approximately $700 million. At the end of fiscal year 2014-15 the total cost of reportable IT projects within the state was roughly $5.0 billion dollars. The projects range from re-engineering the state’s budgeting practices to revamping the state’s prescription drug monitoring platform. The projects vary in size; ranging from an overall project cost of $670 million and over 200 positions to $5 million and five positions. There is a reasonable argument to be made for CalTech oversight of projects of varying size. A larger project is typically more complex and demanding. However, identifying enough qualified staff in the short term will represent a challenge. Alternatively, responsibility of the smaller projects could be assumed almost immediately.

<table>
<thead>
<tr>
<th>Reportable IT Projects</th>
<th>Number</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Active Projects</td>
<td>58</td>
<td>$4.98 Billion</td>
</tr>
<tr>
<td>Anticipated to Start in 2014-15</td>
<td>4</td>
<td>$19.6 Million</td>
</tr>
<tr>
<td>Proposals Pending</td>
<td>27</td>
<td>To be determined</td>
</tr>
</tbody>
</table>

**Staffing Represents the Largest Obstacle for Statewide IT Projects.** The Legislature approved the 2.0 positions within CalTech with the expectation that the office would grow over time over time. In order to provide any kind of impact to the state’s IT portfolio growth within the office will need to be significant. As noted earlier, there are larger projects in the state that require over 200 positions. Identifying qualified candidates to fill the number of positions needed in a short period of time may present a challenge. For example, the Financial Information Systems of California (FI$Cal), currently the state’s largest IT project, has experienced significant staffing difficulties. The January 8, 2013 California State Auditor’s annual status letter on FI$Cal has noted that, at that time, 52 of the projects 161 full-time budgeted positions (32 percent) were vacant. The FI$Cal project was approved in 2007, and staffing challenges remain one of the largest concerns.

Staffing challenges are not unique to FI$Cal. Many other large-scale IT projects within the state also have had a difficult time identifying qualified candidates to fill vacant full-time management positions. OSI has noted that recruiting and retaining qualified staff remains one of the primary obstacles to completing a project on time and on budget as well. While it is clear that IT professionals can seek higher pay in the private sector, there may be other benefits that can be offered by the state to recruit and retain high quality staff. For example, there are a large number of professional development courses that could be provided, contingent upon a commitment to work for the state for a set period of time.
The Administration will need to determine the eventual size of the statewide project management office and reach its full complement. It will be difficult for the Legislature to assess the staffing needs of CalTech if tangible goals for staffing are not identified.

**Changes at CalTech.** Recently, CalTech has undergone a significant amount of change. SB 71 (Budget and Fiscal Review Committee), Chapter 28, Statutes of 2013, modified the way that the state purchases IT enhancements. Prior to the passage of SB 71, the Department of General Services (DGS) was responsible for IT-related procurement for most state agencies. SB 71 shifted much of this function to CalTech and significant changes were made to the IT procurement process. For example, agencies requesting new IT systems are expected to provide a greater level of information earlier in the process.

In its review of previous IT procurement process, CalTech reviewed existing procurement processes and determined that the current IT modernization process was often viewed as cumbersome by both the vendor and the end-user department, required too much time for decision-making, and often relied on outdated data. CalTech modified the IT procurement process with the intent of improving the quality, value, and likelihood of success.

As part of its improvement process, CalTech introduced the Stage/Gate model for IT projects. While state entities must still complete a Feasibility Study Report (FSR), the initial information that they are expected to provide will be different. The introduction of the Stage/Gate model is designed to be more informative on the front-end of the request, and departments/agencies must provide a more accurate project budget estimate and more clearly define the business case that led them to request an upgrade to their IT portfolio. CalTech anticipates that the changes to the IT procurement process will lead to fewer mid-project change orders.

The Stage/Gate model also will break the IT procurement process into multiple stages. Each subsequent stage will be separated by a deliverable, or a gate. After each stage, CalTech will conduct an analysis to determine whether or not the investment remains practical, and if the project should continue. The Stage/Gate model has the potential to reduce the complexity of future IT projects in the state by breaking the project into multiple discrete phases.

The modifications to the IT acquisition process will require a significant amount of attention from CalTech staff. The changes may represent a positive step in improving the state’s IT acquisition process. However, many of the changes in IT procurement could be undermined if adequate resources aren’t dedicated to reforming the acquisition process. Likewise for the statewide project management office, if adequate resources aren’t provided, it will likely fail to provide the expected results.

**Scalability.** Many of the state who scored well in the Digital States Survey were small and it can be difficult to compare the IT efforts of a smaller state with to California, with a population of over 38 million people. However, like other states, California could benefit from transitioning to a centralized IT organization if doing so can provide a greater level of accountability, ensure that lessons learned from IT projects are more likely to be applied to other projects, and training for project management staff is more manageable.
Reportable Outcomes. As noted earlier, accountability represents one of the more significant benefits to transitioning to a centralized IT project management model. The Legislature may wish to consider identifying some reportable information that will provide a greater level of accountability. For example, are there any tangible benefits that can inform the Legislature on the success of the statewide project management office? The University of Utah conducted a study and found that each transaction conducted online rather than in person, saved the state of Utah $13 dollars. Could California see a similar level of savings if a greater number of transactions were to occur online?

It will take several years for the statewide project management office to provide the level of services that are currently provided at OSI. In the meantime, the Legislature may wish to identify reporting requirements that can illustrate progress. For example, the Legislature may wish to consider asking how many new projects have been assumed by the statewide project management office, how many projects will require external, vendor assistance?
California Veterans Services

BACKGROUND

The state performs three primary functions to support the needs of California’s approximately 1.85 million veterans and their families: guidance and representation through the disability and benefits claims process; direct loans for farms and homes; and long-term residential and medical care at California veterans homes. The California Department of Veterans Affairs (CDVA) is designed to support the efforts of the United States Department of Veterans Affairs (USDVA) in providing healthcare and a wide array of other benefits to eligible veterans, including educational benefits, disability compensation, pensions, and guarantees on home loans for eligible veterans. The state and local governments have long played an integral role in assisting the state’s veterans access to benefits provided by the USDVA and, in some cases, provide additional benefits to returning service members. Recognizing that the state can provide an important service to veterans, the state has set aside funds to support the efforts of the USDVA and provide additional benefits, such as long-term residential care and the farm and home loan program.

California remains home to the largest population of veterans in the country. A September 2014 study conducted by the USDVA found that:

- 1,851,470 veterans are living in California.
- Approximately $4.5 billion in compensation and pension is distributed to California’s veterans annually.

The Governor’s budget proposes total spending of $426.7 million ($357.1 million General Fund) for the CDVA. This proposal reflects a $32.2 million dollar increase over expenditures for 2014-15.

### California Department of Veterans Affairs

**Summary of Expenditures**

*(Dollars in Thousands)*

<table>
<thead>
<tr>
<th>Program</th>
<th>2014-15</th>
<th>2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm and Home Loans to Veterans</td>
<td>$62,302</td>
<td>$64,000</td>
</tr>
<tr>
<td>Veterans Claims and Rights</td>
<td>18,173</td>
<td>15,274</td>
</tr>
<tr>
<td>Care of Sick and Disabled Veterans</td>
<td>313,887</td>
<td>347,172</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$394,362</strong></td>
<td><strong>$426,446</strong></td>
</tr>
</tbody>
</table>
Veterans Homes of California. Over 80 percent of the Governor’s proposed budget is dedicated to providing the state’s eligible residents with rehabilitative, residential, medical, and support services in a home-like environment. Currently, CDVA maintains campuses in Barstow, Chula Vista, Lancaster, Ventura, West Los Angeles, Yountville, Redding and Fresno. The Redding and Fresno veterans’ homes were completed in the spring of 2012. The 2014-15 budget includes an augmentation of $8.19 million and 132.2 personnel years to complete staffing ramp-up and admission of residents at the state veterans homes in Redding and Fresno.

Each campus is capable of providing varying levels of care, in accordance with USDVA standards, ranging from domiciliary care to skilled nursing. Overall, there are approximately 2,200 licensed beds, and CDVA maintains a physical capacity of almost 3,000 beds. However, projected census totals show that there will be slightly less than 2,000 residents within the CDVA veterans homes. The table below provides a breakdown of the capacity and care level of each campus.

<table>
<thead>
<tr>
<th>Campus</th>
<th>Physical Capacity</th>
<th>Licensed Beds</th>
<th>Projected 2015-16 Census</th>
<th>Skilled Care</th>
<th>Intermed. Care</th>
<th>Residential Care</th>
<th>Domiciliary Care</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yountville</td>
<td>1,184</td>
<td>1,187</td>
<td>994</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Barstow</td>
<td>400</td>
<td>344</td>
<td>212</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Chula Vista</td>
<td>400</td>
<td>400</td>
<td>290</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>West LA</td>
<td>396</td>
<td>240</td>
<td>271</td>
<td>x</td>
<td></td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Ventura</td>
<td>60</td>
<td>60</td>
<td>60</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lancaster</td>
<td>60</td>
<td>60</td>
<td>60</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redding</td>
<td>150</td>
<td>153</td>
<td>124</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Fresno</td>
<td>300</td>
<td>306</td>
<td>32</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>2,950</strong></td>
<td><strong>2,747</strong></td>
<td><strong>2,144</strong></td>
<td><strong>943</strong></td>
<td><strong>324</strong></td>
<td><strong>634</strong></td>
<td><strong>1,049</strong></td>
</tr>
</tbody>
</table>

In addition to the services highlighted above, the CDVA has been working to provide adult day-health care services in the future at some of the facilities within the CDVA veterans’ homes network. While CDVA currently does not offer community-based adult services (CBAS), the Lancaster and Ventura veterans’ homes are equipped to provide CBAS.

With the addition of two new veterans’ homes in Redding and Fresno, the CDVA is projected to have a physical capacity of nearly 3,000 beds. However, the number of eligible veterans in California continues to decline. This mirrors a trend at the national level. Barring any future conflicts that would require large scale troop commitments, estimates conducted by the U.S. Department of Veterans Affairs have shown that by the year 2035 California will be home to slightly over 1 million veterans. This would represent a significant drop in the overall population of veterans living in California.
**Veterans Claims and Rights.** Veterans currently living in California were provided with disability compensation and/or pension benefits totaling $4.5 billion dollars in 2013. As noted earlier, one of CDVA’s primary missions is to assist eligible veterans, and their dependents, in obtaining federal and state benefits by assisting the veteran with a specific claim. CDVA maintains 92.4 positions to assist the state’s veterans with benefit representation. However, much of the claims representation process is managed by county veterans’ service officers (CVSO). Historically, the Governor’s Budget has provided $2.6 million in General Fund to support the efforts of the CVSOs (there are currently CVSOs in 54 of California’s 58 counties.) The 2014-15 budget included a $3.0 million appropriation to the CDVA in order to augment the CVSO’s budget, on a one-time basis.

Veterans in California receive less than the national average in compensation and pension benefits. Nationally, veterans receive an average of $2,104 per month, while veterans in California received slightly below that at $1,929. While improvements have been made, California’s veterans compensation still trends behind other states that have large veteran populations, such as Texas and Florida.

CDVA has progressed towards modernizing their communications platforms. CalVet Connect, which was released in 2014, is designed to allow a veteran to access federal, state, local, or non-profit organizations that provide services to veterans. The initiative is largely a response to a 2009 report conducted by the California Bureau of State Audits that found that the department offered a limited number of direct services to the state’s veterans and had a limited amount of contact information for veterans living in the state.
ISSUES TO CONSIDER

Greater Coordination Would Benefit Veteran Community. While the CDVA manages a large number of programs and services to benefit veterans, there are also a number of other state and federal agencies that provide veteran-related benefits and resources. Additionally, there are a large number of veteran-oriented non-profit organizations that serve the veteran community. However, many veterans remain unaware of all of the benefits that are available to them. A collaborative effort is needed to ensure that veterans are receiving the maximum level of compensation and benefits available.

Increasing resource navigation capacity—whether in the form of virtual or peer-to-peer assistance enables federal, state, or local dollars dedicated to the veteran community to go further. Developing technology that would enhance the navigation process for veterans and military families and provide some qualitative feedback would enhance their understanding of the approximately 40,000 organizations that provide support to veterans and military families nationally.

Arguably one of the most difficult periods for a veteran is the period of time stretching from before, to the several months after, discharge, which coincides with the loss of several federal resources. Similar resources are available at the federal, state, and local level. CDVA resources could be provided to a service member during the military’s Transitional Assistance Program (TAP), which all members of the military must go through prior to separation. Guidance to services during this time period can often serve as a preventive measure as well. For CDVA to continue to improve veterans awareness of resources CDVA staff will need to participate in the military’s TAP process. The TAP process also represents the best opportunity for CDVA to introduce transitioning military to CalVet Connect.

Guidance for Interagency Council on Veterans May be Necessary. Recognizing the benefits of a collaborative effort, Governor Brown established the Interagency Council on Veterans (Council) in 2011. The primary mission of the Council is to coordinate with all levels of government to ensure that needs of veterans are being addressed. However, when established, there guidelines, reporting requirements, and goals were not defined. If the Legislature wants to maximize the potential of the Council, it may wish to consider identifying tangible goals that the Council should seek to achieve.
Statewide Property Management: Asset Management

BACKGROUND

During the most recent economic downturn, the state was faced with multi-billion dollar deficits that required identifying a number of efficiencies. As part of various strategies to increase efficiencies, reduce spending, and increase revenue, Governor Schwarzenegger and the Legislature developed a plan to sell, and then lease back, 11 state-owned buildings. The total sale was valued at $2.3 billion, and would have netted the state an estimated $1.2 billion in revenue.

Governor Brown, who assumed office in 2011, abandoned the sale-leaseback approach that had been adopted by the prior administration. Due to the rapid decrease in real estate prices, Governor Brown noted that the sale-leaseback approach would not benefit the state in the long term. Shortly thereafter, Governor Brown directed state agencies to identify and report state property holdings to the Department of General Services (DGS) in an effort to relieve the state of property that served no programmatic value. In 2012 Governor Brown issued an executive order reiterating the directive to consolidate state staff into under-utilized state-owned space.

Scrambling to identify valuable surplus property that could be sold to provide revenues to fill a budget gap underscored the state’s lack of a functional process to manage its own property holdings. During a strained fiscal environment there is an expectation that DGS, and other state departments, will identify surplus property. However, once the state has emerged from an economic downturn, the interest in managing the surplus property process dissipates. Focusing strictly on surplus property overshadows the question of whether or not state property holdings are being managed effectively.

Within DGS the Real Estate Services Division is responsible for managing statewide real estate functions for the state. The Real Estate Services Division is comprised of five branches: Asset Management, Business Operations, Policy and Planning, Building and Property Management, Professional Services, and Project Management. The Asset Management branch often serves as the first point of contact for agencies or departments seeking new services. One of the primary functions of the Asset Management branch is to assess proposed projects and determine whether or not they are consistent with regional facility plans. Additionally, the branch is responsible for making tenant/property improvements to underutilized state-owned properties.
**Surplus vs. Excess Property.** One of the programs within the Asset Management branch is the surplus sales program. The process of identifying and selling state property is governed by statute, and requires a number of steps to be taken prior to property disposition. The process is designed to be transparent in order to best benefit the public. Current statute differentiates between “excess” and “surplus” property. Excess property includes land that is currently not being used at all, or not used to its fullest potential. Surplus property is excess property that the state no longer deems as necessary for any programmatic purpose. All departments, except the California Department of Transportation (Caltrans), must participate in the state’s surplus property program. Caltrans has its own process to identify and dispose of surplus property.

**Surplus Property Inventory.** In accordance with statute, state agencies, departments, boards and commissions, are required to submit their property holdings to DGS on an annual basis. The Surplus Property Inventory (SPI) serves as the state’s main record keeping system for tracking statewide surplus assets. The SPI contains information related to the state’s real property assets, including land, structures, improvements and leased space, as well as state-owned leased space to other tenants. However, as noted above, the database does not include information on Caltrans, who are exempt from providing the required information.
In order to update the SPI, DGS sends records to each agency with its known listings. Each agency is then responsible for updating the file. To ensure a greater level of accuracy and compliance DGS has required that the updated records include a signature from each department director. The process is time consuming and often lacks accuracy. The database itself can be difficult to navigate and it is difficult to determine the state’s property holdings.

**Sales From Proceeds Go to the State General Fund.** According to statute, departments do not receive any of the proceeds that may come from the sale of a parcel of surplus property. Historically, proceeds have been directed benefit the state’s general fund. In 2004, California’s voters passed Proposition 60, which requires that proceeds from the sale of most state property be applied to principal and interest payments for the state’s $15 billion Economic Recovery Bonds that were authorized by voters. During fiscal year 2014-15 the state plans to accelerate payments on Economic Recovery Bonds, paying an additional $1.6 billion, in order to fully retire debts owed on Economic Recovery Bonds.

**State’s Assets.** California’s state land and property holdings are diverse, and are used for a variety of purposes, including university campuses, reservoirs, mental hospitals, veterans homes, and laboratories. According to the Surplus Property Inventory, the state owns 2,901 real properties and 2,351 buildings. The state’s real estate portfolio totals approximately 6.9 million acres across the state. The state’s largest holder of public land is the California State Lands Commission, which holds nearly 4.5 million acres.

**ISSUES TO CONSIDER**

**Data may need to be improved.** To improve the state’s inventory of surplus property, the Legislature may wish to consider mandatory audits of state property. Texas currently utilizes this model that requires all state property be audited every four years, or 25 percent of the state’s holdings be audited annually. The audit includes appraisals, how the property has been improved, best use, and identifies when property holdings are being underutilized.

**Further leveraging state assets.** As noted earlier, updating the SPI requires that each agency provide accurate data to DGS. The process requires multiple steps and can be time consuming for staff charged with updating their inventory records. The current generational transition in the state workforce provides for an opportunity to leverage technology within the state for better property management practices.

DGS may want to consider leveraging current state assets to better improve updating SPI’s data. Also, leveraging state assets would more closely align with private sector best practices. For example, DGS could consult with the Department of Technology (CalTech) and utilize Caltech’s Geospatial Information Systems (GIS) mapping capacity. GIS is a computer system designed to capture, store, and manipulate spatial or geographical data. By collaborating with CalTech and using GIS mapping systems DGS may be able to abandon the current method of updating the SPI, which can be unreliable.
A unified Asset Management approach may improve future decision-making. There have been a number of reports that have drawn a similar conclusion; the current organizational framework does not provide California’s asset management system with any one entity in charge. In most cases, DGS serves more of a custodial role in managing state property. The state lacks an entity that can provide central coordinating asset management efforts. Agencies often conduct their asset management functions in silos and decisions are made with little leadership, and without reference to an overarching strategy.

At one point, the state did have such an entity providing asset management decisions as a centralized function. In 1989, the Governor’s Office of Planning and Research (OPR) was charged with proactively managing the state’s assets. The task of managing state assets was removed from OPR in the mid ‘90’s and since then, the state has lacked a centralized asset approach. The state’s fiscal climate has improved, and it would be best for the Legislature to address the lack of an overarching strategy before it becomes a necessity.
California Disaster Assistance Act

BACKGROUND

California is home to over 800 miles of coastline, dozens of fault lines, and thousands of square miles of forest. California is also home to nearly 40 million residents. Unfortunately, the extensive coastline, fault lines, and forestry in the state combined with the large population base create a recipe for costly man-made and natural disasters. Recognizing this, the Legislature adopted the Natural Disaster Assistance Act (NDAA) in 1974. The NDAA was established to provide financial and other assistance to local governments for the repair and restoration of public property. Subsequent changes made by the Legislature modified the qualifications for assistance to include acts of terrorism and health epidemics. In light of these additions, the Legislature renamed the NDAA the California Disaster Assistance Act (CDAA).

The state relies on a mutual aid system, which is categorized into four organizational levels; cities, counties, regions, and the state. Local emergency agencies will often serve as the first responders in the event of a disaster. Depending on the scale, additional resources may be required. During a major emergency the California Office of Emergency Services (OES) can call upon state or local agencies with specific response and recovery capabilities. For example, the recent 6.1 magnitude earthquake in Napa Valley required respondents not only from the city and county of Napa, but also neighboring cities and counties. As it became clear that the recovery would require additional state resources, a disaster declaration was issued by Governor Brown.

Response and Recovery. The OES serves as the state agency responsible for coordination of disaster response in support of local government. Additionally, OES is responsible for readiness efforts to respond and recover from natural and man-made disasters, and for assisting local governments in their emergency preparedness, response and recovery efforts. Given their similar roles, the state has tried to align OES functions as closely as possible to those of the Federal Emergency Management Agency (FEMA), which in the event of a federally declared disaster, serves as the chief coordinating agency at the federal level. The alignment assists OES’ efforts to serve as the “grantee” for federal disaster assistance and as the central agency in the recovery process.

The OES also has the authority to serve as the grantor of the CDAA program. The application process for the CDAA program requires that a local agency submit an application to OES within 60 days of the date of the local proclamation. Additionally, the applicant must have incurred a minimum aggregate total damage of $2,500 in order for costs to be eligible under CDAA. The process for requesting CDAA funds is listed below:

- Preliminary damage assessment (often conducted in coordination with OES).
- Governor’s Proclamation or notice of concurrence issued by the Director of OES.
- Application submission and a briefing provided by applicant.
Meeting, project formulation, and cost estimates are conducted.

Project review and validation.

Obligation of funds.

Project completion.

Final claim process and closeout.

The 2014-15 budget provided the disaster assistance fund, which is the fund source for the CDAA, with approximately $39 million general fund. The amount funded each year varies depending on local agencies are seeking for work conducted in prior years. The disaster assistance fund is designed to provide eligible projects with a cost share of 25 percent at the local level. The state share for eligible projects may not exceed 75 percent, unless specified in statute. CDAA funding is only available to local (county and city) entities.

The close alignment with FEMA is designed to provide for a more seamless recovery effort. It is likely that a disaster will occur in one centralized region where local first responders will be the first on the ground. In the event that local first responders are not adequately resourced to address the emergency they can seek assistance from the state – by declaration of a local emergency, which allows the state to respond. The state is then able to provide state resources, such as National Guard units, or other state resources. Meanwhile, a preliminary damage assessment is conducted by state, local, federal and volunteer agencies. Upon completion of the preliminary damage assessment, the Governor may issue a state disaster declaration. Depending on the size and scale of the damage. The declaration commits funds and resources to the long-term recovery effort. After a declaration has been made, CDAA funds may be made available to eligible applicants. If the disaster exceeds the state’s capacity to respond adequately the Governor may seek federal assistance. At this point in the process, FEMA assesses the request and provides the White House with a recommendation as to whether or not federal support shall be provided.

While there are a number of factors taken into consideration, cost plays a major factor in determining if assistance is needed. Both the state and FEMA utilize a per-capita cost threshold as one of the determining factors in providing assistance. Currently, the federal threshold for California is slightly over $51 million, a per-capita cost of $1.37 per resident. The $51 million threshold is based on the 2010 census figures, which showed that California has slightly under thirty-eight million residents. The $1.37 figure, which was last adjusted in 2012, is utilized by FEMA uniformly to ensure parity throughout the U.S. Similarly, the state utilizes a cost threshold in determining if assistance is needed. The cost threshold for each county is $3.45 per resident.
While the design of the federal and state disaster assistance programs is similar, there are a few differences. The table below outlines some of the differences between the two programs:

### Differences between FEMA and CDAA disaster assistance programs

<table>
<thead>
<tr>
<th>Issue</th>
<th>Federal Declaration</th>
<th>State Only - CDAA</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FEMA</td>
<td>CDAA</td>
</tr>
<tr>
<td>Application Deadline</td>
<td>30 days from declaration date</td>
<td>30 days from declaration date</td>
</tr>
<tr>
<td>Emergency Work</td>
<td>Eligible (only overtime) salary and benefits for public safety and emergency services personnel.</td>
<td>75 percent of cost share of FEMA eligible costs</td>
</tr>
<tr>
<td>Permanent Work</td>
<td>Eligible</td>
<td>75 percent cost share of FEMA eligible costs</td>
</tr>
<tr>
<td>Emergency Work Completion Deadlines</td>
<td>6 months</td>
<td>6 months</td>
</tr>
<tr>
<td>Permanent Work Completion Deadlines</td>
<td>18 months</td>
<td>18 months</td>
</tr>
<tr>
<td>Appeals</td>
<td>Applicant must submit request within 60 days from receipt of determination.</td>
<td>N/A</td>
</tr>
<tr>
<td>Fair Hearing Request</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

References: *California Disaster Assistance Act, Government Code, Section 8685-8587.8
*Title 19, Sub Chapter 6 – California Disaster Assistance Act
*Government Code Chapter 7.5, Sections 8680 through 8692, California Disaster Assistance Act
*Title 44 of the Code of Federal Regulations
ISSUES TO CONSIDER

State reporting lacks a hazard mitigation plan. FEMA requires an applicant for disaster funds to describe how it plans to implement long-term hazard mitigation measures after a major disaster declaration. However, the application process at the state level does not include a similar section dedicated to hazard mitigation. To address a potential recurring loss of public property the state may want to consider including a hazard mitigation plan in the state-level disaster relief process.

Transparency could be improved. Currently, the process for distributing CDAA disaster assistance funds lacks reporting requirements. There is a line item in the budget for the disaster assistance fund; however, it does not indicate which specific local projects are projected to be reimbursed on an annual basis. Annual reporting requirements, that itemized the projects being reimbursed would increase the transparency of the CDAA process.
Local Government Mandates

BACKGROUND

The proposed funding for non-education mandate payments to local governments is included in the budget of the Commission on State Mandates (Commission). The Commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments, and for establishing the appropriate reimbursement to local governments from a mandate claim. The Constitution generally requires the state to reimburse local governments when it mandates that they provide a new program or higher level of service. Activities or services required by the Constitution (as opposed to statute) are not considered reimbursable mandates. The Constitution, as amended by Proposition 1A of 2004, generally requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution. However, there are two exceptions to this rule:

- Payments for mandate costs incurred prior to 2004 can be repaid over time, but statutorily required to be fully paid by 2020-21.

- Payment of costs of labor relations-related mandates may be deferred while still retaining the mandate’s requirements.

Mandate reimbursement claims are filed with the Commission for the prior fiscal year—after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the following fiscal year. For example, local costs incurred in 2013-14 are reported and claimed in 2014-15, and the state will reimburse locals for these costs as part of the 2015-16 budget. Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment on these claims. For example, several elections-related mandates were suspended for the first time in the 2011-12 budget. This means the activities for locals were optional in 2011-12 and locals cannot claim reimbursement for any new costs incurred in 2011-12. However, the mandate claims for these costs in 2009-10 and 2010-11 are still due—either over time or all at once in a year when the mandate suspension is lifted. The state owes local governments approximately $1.8 billion in non-education mandate payments. Of this, about $790 million (which includes interest of $170 million) is associated with pre-2004 mandate claims.
Funded Mandates
The Governor’s mandate proposal is largely a continuation of the status quo in terms of mandates in effect and mandates not in effect. The budget proposes expenditures of $44.2 million related to non-education mandates. The budget would continue to fund the 13 mandates that were kept in force for 2014-15, the payments on which constitute the bulk of the General Fund cost. In addition, the budget proposes funding a one-time payment of $9.6 million to address the back costs local agencies accrued from 2001 to 2013 in performing activities related to the Public Records Act mandate. (In 2014, California voters approved Proposition 42, which placed the Public Records Act in the Constitution and removed the state’s ongoing responsibility to fund the Public Records Act mandate). The budget also provides $218,000 to fund the Accounting for Local Revenue Realignments mandate which involves county administrative costs associated with funding changes in 2003-2004 that addressed budget shortfalls at that time. Two additional funded mandates relate to Local Agency Ethics and Tuberculosis Control. Most mandates funded in the budget concern public safety or property taxes. Funded mandates are listed in the following table.

<table>
<thead>
<tr>
<th>Mandate Title</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting for Local Revenue Realignments</td>
<td>$218</td>
</tr>
<tr>
<td>Allocation of Property Tax Revenue</td>
<td>530</td>
</tr>
<tr>
<td>California Public Records Act</td>
<td>9,674</td>
</tr>
<tr>
<td>Crime Victim’s Domestic Violence Incident Reports</td>
<td>178</td>
</tr>
<tr>
<td>Custody of Minors-Child Abduction and Recovery</td>
<td>12,216</td>
</tr>
<tr>
<td>Domestic Violence Arrests and Victim’s Assistance</td>
<td>1,467</td>
</tr>
<tr>
<td>Domestic Violence Arrest Policies</td>
<td>7,481</td>
</tr>
<tr>
<td>Domestic Violence Treatment Services</td>
<td>2,082</td>
</tr>
<tr>
<td>Health Benefits for Survivors of Public Safety Officers</td>
<td>1,816</td>
</tr>
<tr>
<td>Medical Beneficiary Death Notices</td>
<td>10</td>
</tr>
<tr>
<td>Peace Officer Personnel Records</td>
<td>704</td>
</tr>
<tr>
<td>Rape Victim Counseling</td>
<td>351</td>
</tr>
<tr>
<td>Sexually Violent Predators</td>
<td>7,140</td>
</tr>
<tr>
<td>Threats Against Police Officers</td>
<td>3</td>
</tr>
<tr>
<td>Tuberculosis Control</td>
<td>8</td>
</tr>
<tr>
<td>Local Agency Ethics</td>
<td>36</td>
</tr>
<tr>
<td>Unitary Countywide Tax Rates</td>
<td>260</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$44,174</strong></td>
</tr>
</tbody>
</table>

Note: *italics* indicates that mandate is newly funded in the proposed budget.

Paying For Pre-2004 Claims
Pursuant to the constitutionally required reimbursement, the 2014-15 budget included $100 million to reduce the outstanding balance for pre-2004 local government mandate claims. In addition, the current year budget incorporated a trigger mechanism that could result in an additional payment under specified conditions. This trigger will be activated if May Revision estimated revenues for the two years exceed the prior year’s May Revision estimated revenues. The Department of Finance (DOF) currently estimates that the trigger amount that will be paid is $533 million, leaving $257 million remaining to be paid by 2020-21, as required by the passage of Proposition 1A.

**Budget Savings**

The budget incorporates a total of $984.5 million in savings from maintaining mandate suspensions or deferring payment of claims. Some 56 mandates are suspended under the budget proposal. In addition, payments on another 15 mandates that have been deferred or have expired have been delayed. The savings breakdown is as follows: (1) $276.4 million savings from deferring payment of post-2004 mandate claims for mandates that have since expired or are otherwise not in effect; (2) $620.3 million savings by continuing the suspension of certain local mandates; and, (3) $87.8 million savings from deferring payment on employee-rights mandates in effect. In prior years, there have been proposals to repeal certain mandates, but no such repeal is proposed in the budget. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code, improves statutory transparency, and provides more certainty to local governments.

The budget does address one existing mandate in a new way, in an attempt to deal with its significant costs. The Interagency Child Abuse and Neglect Investigation Reports mandate requires certain local agencies to conduct various activities related to child abuse investigations and to provide reported child abusers due process protections. The Commission adopted a $90.3 million statewide cost estimate which reflects the affected agencies’ costs to comply with this mandate from 1999 to 2011. The budget suspends this mandate on the basis that these activities are long-established and involve the agencies’ core missions. The budget creates a $4 million optional grant program, administered by the Department of Social Services, as a substitute funding mechanism for these activities.

**ISSUES TO CONSIDER**

Determining whether a particular requirement is a state-mandated local program, and the process by which the reimbursable cost is determined, is an extensive, time-consuming, and multi-stage undertaking. State and local officials have expressed significant concerns about the mandate determination process, especially its length and the complexity of reimbursement claiming methodologies.

**Delays in the Process**

According to a Legislative Analyst’s Office (LAO) review a few years ago, it took the Commission several years to complete the mandate determination process for a successful local government test claimant. The review of new mandates claims found that the Commission took
almost three years, from the date a test claim was filed, to render a decision as to the existence of a state-reimbursable mandate. The Commission took about another year to adopt the mandate’s claiming methodology, and almost another year to estimate the costs and report the mandate to the Legislature. Because of the current backlog, the delay can be even longer. It is important to note that these delays are not necessarily within the Commission’s control. In addition, with additional resources, the Commission has attempted address the backlog issues that are within its purview. These ameliorative actions are likely to speed up the mandate process but the resulting improvements are expected to fall short of meeting the statutory time frame.

This lengthy period presents several difficulties that affect both the state and local governments. Among the most important are flip sides of the same coin, specifically:

- Local governments must carry out the mandated requirements without reimbursements for a period of some years, plus any additional time associated with development of the mandate test claim, appropriation of reimbursement funds, and the issuance of checks.

- State mandate liabilities accumulate during the determination period and make the amount of state costs reported to the Legislature higher than they would be with an expedited process. Policy review of mandates is hindered because the Legislature receives cost information for a mandate years after the debate regarding its imposition.

**Transparency and Reform**

One of the more troubling aspects of mandate law, and the mandate process, is the lack of transparency regarding the obligations of local governments. The process of mandate suspension, which allows the state to not fund the mandate, leaves in place the statutory requirement regarding the activity. Consequently, a reading of the relevant statute would indicate that such a mandated activity is required to be carried out by local governments; however, unless the mandate is funded in the budget, it is deemed to be suspended, relieving local governments of the obligation to conduct the activity. The LAO has gone on record regarding the confusion and misunderstanding caused by this inconsistency for local governments and the public.

There have been two recent attempts to reconcile this information and eliminate the inconsistency with respect to suspended mandates. As part of the 2012-13 budget, the Governor proposed repealing 32 of 56 long-suspended mandates. Although the proposal was heard in appropriate subcommittees, ultimately the Legislature did not act on the proposal through the budget process, with the general view expressed that the policy committee process was the appropriate venue.

As part of the 2013-14 budget, the Governor approached the mandate issue with a more nuanced proposal and the Legislature, to a large extent, initially agreed to this more surgical approach. In budget trailer bill, the Administration proposed ‘making permissive’ five mandates that had been suspended at least since 1990, consisting of: Adult Felony Restitution, Minors’ Victims Statements, Deaf Teletype Equipment, Pocket Masks, and Domestic Violence Incident Reporting. All were initially approved to be made permissive, but the Domestic Violence Incident Reporting statutory language was subsequently reinstated. During the process, there was some confusion as to the effect of mandate suspension and the practical impact on required...
activities of local governments. The process involving mandated portions of the Open Meetings Act displayed similar confusion about the mandate process.

Implementation Alternatives
As part of the 2014-15 budget, the Legislature approved budget bill language that requires the DOF to provide a report on local election mandates that evaluates simpler mechanisms and alternative funding, assesses as to whether modifications can be made to achieve lower costs, and estimates statewide costs associated with the goals of the mandates. This report has not yet been provided to the Legislature for its consideration, but could provide a prototype for alternative means of mandate implementation and reimbursement of local government activities.

Other Issues
In addition to the delays that characterize the mandate review and determination process, there are other significant issues. On the cost determination side, since most mandates relate to expanding existing programs (rather than instituting completely new ones), local governments have difficulty in measuring the marginal costs. The complexity of the claiming methodologies means local governments’ claimed costs frequently are not supported by source documents showing the validity of such costs, or are not allowable under the mandate’s reimbursement methodology. Accordingly, the State Controller’s Office has disallowed a significant number of reimbursement claims over the last few years, leading to frequent appeals, more uncertainty and mounting bills.

As part of the 2013-14 budget, the Administration indicated that it would pursue policies to improve the mandate process, including deferring decisions to local government decision-makers and allowing for maximum flexibility. The proposal to make certain mandates permissive was part of this effort. In addition, the LAO has in the past recommended a ‘best practices’ approach for various local activities and requirements. The Legislature could consider these approaches and compare their advantages to policies adopted at the state level and the likely costs of such mandated programs; however, to date, a comprehensive plan to improve the mandate process overall has not been provided to the Legislature.
Infrastructure Investment

BACKGROUND

Overview
The quality of California’s public infrastructure is integral to the state’s economic performance as well as for the delivery of various governmental goods and services. Much of the state’s infrastructure—especially its extensive state and local transportation networks—are directly related to the performance and growth of the state’s economy. Other components of the state’s infrastructure provide support for the functioning of the state’s various institutions—such as those related to public safety, court facilities and state hospitals. Still other infrastructure components possess qualities that relate both directly and indirectly to the state economy—such as educational facilities and water supply and treatment systems. It is generally recognized that—across the board—California has considerable infrastructure needs along with a backlog of required maintenance for existing infrastructure.

The condition of California’s infrastructure and the on-going level of investment have been of concern for some time. The recent severe recession, and the associated budget reductions that it necessitated, have only increased the level of concern. In recognition of the importance of a strong infrastructure backbone, since 1999, the California Infrastructure Planning Act (CIPA) has required the Administration to submit to the Legislature a five-year infrastructure plan for consideration with the annual budget bill. The report was not provided for several years, but was issued with the Governor’s Budget in 2014 as well as this year. The Administration’s report to the Legislature—California’s Five-Year Infrastructure Plan 2015—notes that: “The investment in physical infrastructure is a core function of state government. Infrastructure and capital assets allow for the delivery of public services and the movement of goods across the state, both essential components in fostering the state’s long-term economic growth.”

State and local governments are largely dependent on macro-economic trends for the performance of their economies. When the national and regional economies are performing in a robust manner, generally state and local economies prosper as well; similarly, when economic downturns occur, state and local economies are not immune. However, to ensure the maximum benefit during economic upticks—as well as to minimize the negative repercussions associated with economic contractions—state and local governments can undertake capital investment initiatives. Among the most effective is investment that expands or improves its infrastructure.

Economic Benefits of Infrastructure Investment
The presence of high quality infrastructure is broadly perceived as essential for economic performance and growth. In its study of global competitiveness, the World Economic Forum (WEF) describes infrastructure as the second of its twelve pillars of economic competitiveness.¹ The 2014-15 WEF report notes:

¹ The first pillar is sound, efficient and fair legal and administrative institutions.
“Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor in determining the location of economic activity and the kinds of activities or sectors that can develop within a country. Well-developed infrastructure reduces the effect of distance between regions, integrating the national market and connecting it at low cost to markets in other countries and regions. In addition, the quality and extensiveness of infrastructure networks significantly impact economic growth and reduce income inequalities and poverty in a variety of ways.”

Economists have long viewed infrastructure as a key ingredient for productivity and growth, and the perceived importance of capital infrastructure for economic growth extends across political and ideological lines. The National Association of Manufacturers favorably cites the WEF report in its contracted report calling for a more competitive infrastructure in the US. In a recent paper, the Economic Policy Institute notes that, “...there is an enormous amount of economic evidence demonstrating that public investment (in infrastructure) is a significant long-run driver of productivity growth....” Although differences exist about the right approach to investment—including regarding who should provide the infrastructure; how it should be financed; the type and magnitude of the benefits that accrue; and what projects should actually be undertaken—few question infrastructure’s key role in economic performance.

Infrastructure investment results in both short-run and long-run effects. In the short-run, infrastructure investment results in additional demand for capital and labor and an increase in economic output. In the long run, infrastructure investment raises productivity by reducing transaction and other costs, thus allowing a more efficient use of productive inputs. States and local governments are in a unique position regarding the allocation of resources—that is, deciding what, where, how much infrastructure investment. A substantial body of research indicates that public investment continues to result in large returns to private-sector productivity and economic growth. To the extent that upgrades and maintenance result in more intensive and efficient use, these returns are also likely to be considerable. Of course, the return to investment will be dependent on the type of investment, among other factors. For example, reinvestment in transportation is likely to generate higher returns than investment in public capital with a less direct impact on the private sector.

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5 While the exact relationship of public capital investment and private sector productivity is open to ongoing debate and additional modeling, several economic studies have estimated rates of return ranging from 15 percent to 45 percent.
Infrastructure Defined

A few key characteristics distinguish infrastructure from other types of capital assets. First, infrastructure investments are often large, capital-intensive projects that tend to be natural monopolies, in that it is often more cost-effective for services to be provided by a single entity. Second, they tend to have significant up-front costs, while the benefits, or returns, accrue over very long periods of time, often several decades. This longevity, and the associated difficulty of ascertaining returns over time, can pose a challenge to private financing and provision. Third, infrastructure investments have the potential to generate positive “externalities,” in the sense that the social return (public and private) to a project can exceed the private market return. This feature can lead to under-provision of needed investments. For these reasons, infrastructure has historically been provided by the public sector, public-private partnerships, or regulated private entities.

In more prosaic terms, infrastructure is generally understood to consist of public physical capital such as roads, school buildings, water and sewer systems and parks. In the state’s five-year infrastructure plan, the Administration breaks these various pieces of infrastructure into different departments, such as those associated with transportation, water resources, natural resources, criminal justice, health services, and general government office space. It is relatively easy to imagine how quality infrastructure can translate into improved private sector productivity—and returns to labor and capital—and thus state economic output, simply by considering the nature of infrastructure assets. In addition to infrastructure components that are directly related to private sector activity, such as roads, state infrastructure needs also include more general government components such as government buildings and prisons, and specialized capital investment, such as educational facilities. A rough outline of California’s stock of infrastructure is provided below:

<table>
<thead>
<tr>
<th>State of California</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Major State Infrastructure</strong></td>
</tr>
</tbody>
</table>

### Transportation
- More than 50,000 miles of highway and freeway lanes.
- 7.8 million square feet of Department of Transportation offices, shops, materials laboratories, and maintenance facilities.
- 170 Department of Motor Vehicles offices.
- 103 California Highway Patrol area offices.

### Criminal Justice
- 34 prisons and 42 correctional conservation camps.
- 4 youthful offender institutions (3 facilities and 1 conservation camp).
- Roughly 20 million square feet managed by the judicial branch.
- 11 crime laboratories.

### Water Resources
- 34 storage facilities, lakes, and reservoirs.
- 20 pumping plants.
- 4 pumping–generating plants.
- 5 hydroelectric power plants.
- 700+ miles of canals and pipelines—State Water Project.
• 1,595 miles of levees and 55 flood control structures in the Central Valley.

**Natural Resources**
• 280 state park units containing 1.6 million acres and over 4,400 miles of trails.
• Over 500 CalFire facilities (including 228 forest fire stations, 39 fire/conservation camps, and 13 air attack bases).
• 16 agricultural inspection stations.

**Higher Education**
• 10 University of California campuses.
• 23 California State University campuses.

**Health Services**
• 5 mental health hospitals.
• 4 developmental centers.

**General State Office Space**
• 556 state–owned office structures covering 23 million square feet.
• 941 leases for 13 million square feet of state office space.

Source: Legislative Analyst’s Office

**Public Investment Trends and Levels**
Investment in infrastructure has dropped in recent decades as a percentage of economic output. This is true globally, nationally, and in the state. Not only has public investment declined, but the value of public capital stock has also declined as a share of national output. Nationally, the Congressional Budget Office (CBO) indicates that between 1956 and 2003, public infrastructure spending was on average about one percent less that GDP growth. For the period 2004 through 2012, the CBO notes a substantially greater average annual negative spread of almost three percent. Thus, in real terms the growth rate for infrastructure was negative during this most recent period. The decline in real spending on infrastructure occurred in almost all categories in the U.S. as a whole, as shown in the table below:

### National Public Infrastructure Expenditures
**2003-2012**
(Real Dollars in Billions)

<table>
<thead>
<tr>
<th>Spending Category</th>
<th>2003</th>
<th>2012</th>
<th>Average Annual Change</th>
<th>Cumulative Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Gross Domestic Product</td>
<td>13,724.40</td>
<td>16,244.60</td>
<td>1.7%</td>
<td>18.4%</td>
</tr>
<tr>
<td>Highways and Streets</td>
<td>193.22</td>
<td>155.98</td>
<td>-2.4%</td>
<td>-19.3%</td>
</tr>
<tr>
<td>Mass Transit</td>
<td>61.43</td>
<td>58.57</td>
<td>-0.5%</td>
<td>-4.7%</td>
</tr>
<tr>
<td>Rail</td>
<td>1.73</td>
<td>1.78</td>
<td>0.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Aviation</td>
<td>42.57</td>
<td>36.89</td>
<td>-1.6%</td>
<td>-13.4%</td>
</tr>
<tr>
<td>Ports and Inland Waterways</td>
<td>11.73</td>
<td>9.58</td>
<td>-2.3%</td>
<td>-18.3%</td>
</tr>
<tr>
<td>Water Resources</td>
<td>11.08</td>
<td>11.42</td>
<td>0.3%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Water Supply and Waste Disposal</td>
<td>102.37</td>
<td>104.97</td>
<td>0.3%</td>
<td>2.5%</td>
</tr>
<tr>
<td><strong>Total Public Infrastructure Spending</strong></td>
<td>423.87</td>
<td>379.19</td>
<td>-1.2%</td>
<td>-10.5%</td>
</tr>
</tbody>
</table>

Sources: Congressional Budget Office; Office of Management and Budget, Bureau of Economic Analysis, National Income and Product Accounts and Fixed Assets Database.
In prior decades, California had invested heavily in various resources and transportation projects. While the state’s overall investment in new capital may not match the historical levels, relative to the size of the state’s economy, California’s Five Year Infrastructure Plan 2015, identifies some $56.6 billion in planned capital outlay through 2018-19, with the bulk of this ($52.8 billion) for transportation projects—split roughly equally between high-speed rail and the Department of Transportation (Caltrans). As the state population continues to grow—the Administration currently estimates that it will reach 50 million by 2050—this will drive additional demands for infrastructure investment. The Administration’s report does not identify infrastructure financing demands in future years, but this is potentially in the mid-hundreds of billions of dollars.

While the state’s infrastructure investment needs are great, maintenance needs are also substantial. In many cases, the state has under-invested in routine maintenance and repairs, resulting in further deterioration of facilities. As noted by the Legislative Analysts’ Office (LAO), much of the state’s immense stock of existing infrastructure is aging and in need of repair or replacement. For example, four out of five state hospitals and about 70 percent of the Department of Forestry and Fire Protection’s forest fire stations are more than 50 years old. Caltrans estimates that 16 percent of the state’s highway lane miles are in poor condition. The Administration’s report identifies a significant backlog of maintenance costs of some $66.1 billion—again with the bulk of the backlog ($59.0 billion) in transportation. For the current year, the plan calls for maintenance commitments of $478 million, roughly 0.7 percent of the identified need. It also stands to follow that additional capital infrastructure projects will inevitably lead to higher maintenance costs.

**CURRENT POLICY AND GOVERNOR’S PROPOSAL**

The Administration has put forth thoughtful and reasonable proposals in certain areas where additional resources are warranted. Notably, the ongoing efforts to reduce and then eliminate budgetary debt will result in reduced interest costs to the state, additional latitude for special funds from which the resources were borrowed, and fewer expenditure obligations resulting in greater budgetary flexibility in the longer term. Similarly, the Legislature and the Administration have cooperated in structuring an approach to addressing shortfalls in the funding of CalSTRS’s liabilities, and the Administration has put forth a general approach to address retirees’ healthcare costs which are now funded on a ‘pay-as-you-go’ basis. While the Administration’s five year infrastructure plan represents a modest start in the infrastructure discussion, work remains in designing a feasible approach for identifying, prioritizing and financing the state’s infrastructure needs, as well as institutionalizing an ongoing program.

In his inaugural address, the Governor emphasized the need to focus on California’s infrastructure. He stated, “We must also deal with the long-standing infrastructure challenge. We are finally grappling with the long-term sustainability of our water supply through the recently passed Proposition 1 and our California Water Action Plan. Equally important is having the roads, highways and bridges in good enough shape to get people and commerce to where they need to go. It is estimated that our state accumulated $59 billion in needed upkeep and maintenance. Each year we fall further and further behind and we must do something about it.”
The Administration’s plan represents an improvement over last year’s plan by including project specific information, such as information on project status and project phase. While the latest plan represents a call to arms, the Administration has not been specific regarding a logical and viable financing approach. The Administration’s identified capital program for five years and maintenance efforts for the budget year is outlined below:

<table>
<thead>
<tr>
<th>Program Area</th>
<th>Five Year Capital Funding</th>
<th>Budget Year Maintenance Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Judicial Branch</td>
<td>$1,224</td>
<td>$0</td>
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<tr>
<td>Transportation*</td>
<td>$52,803</td>
<td>$0</td>
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<tr>
<td>Natural Resources</td>
<td>$1,398 $22</td>
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<tr>
<td>Environmental Protection</td>
<td>$366</td>
<td>$0</td>
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<td>Health and Human Services</td>
<td>$180 $14</td>
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</tr>
<tr>
<td>Corrections and Rehabilitation</td>
<td>$126 $15</td>
<td></td>
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<tr>
<td>Education</td>
<td>$234 $406</td>
<td></td>
</tr>
<tr>
<td>General Government</td>
<td>$243 $21</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$56,574</strong></td>
<td><strong>$478</strong></td>
</tr>
</tbody>
</table>

Source: Department of Finance
*Includes High Speed Rail

Most state facilities are intended to provide benefits over many years, and it is reasonable and appropriate that current and future taxpayers and beneficiaries provide the funding. Thus, bonding for such projects is not only often the most feasible option; it is typically the preferred option. Pay-as-you-go financing is also appropriate to the extent that payments show correspondence with the use and depletion of the public capital. Given the volume of the state’s infrastructure needs and other competing priorities (including debt service on existing bonds), it is likely that bonds will continue to play a major role in infrastructure funding well into the future. These could be either general obligation bonds or bonds financed by user fees depending upon the distribution of benefits and the feasibility of collecting user charges.

Regarding state financing, California has steadily increased its reliance on debt to fund capital projects, resulting in debt-service-related cost pressures to the state’s General Fund. The extent in which the state undertakes additional borrowing will affect the state’s debt-service ratio—the portion of the state’s annual General Fund revenues required for debt-service payments. The debt-service ratio has changed over time, peaking at about six percent in 2009-10 and 2010-11, according to LAO. If currently authorized bonds are issued, the debt-service ratio could reach close to these levels again in 2015-16. LAO notes that while there is no ‘correct’ debt-service ratio, elevated levels do restrict the ability to pay for other programs. Thus, the debt-service ratio provides an indication of the relative priority of debt service and infrastructure compared to other General Fund spending, with higher ratios associated with prioritization of infrastructure spending. Because debt payments are generally fixed and cannot be easily reduced by restructuring, they are significantly less flexible than other types of expenditures.
On the local financing side, local governments have a variety of means to raise resources for capital outlay. School and community college districts can raise local revenue for their projects through local bonds, developer fees, facility improvement district levies, and parcel taxes. Proposition 39 (enacted by voters in 2000) increased the ability of school and community college districts to help fund their infrastructure by reducing the vote requirement for local bond measures from two-thirds to 55 percent. Cities and counties may avail themselves of some other existing programs, including business improvement districts (BIDs), infrastructure improvement districts (IFDs), property tax debt overrides, Mello-Roos financings, assessment levies, or other types of parcel taxes.

Last year the Administration proposed easing the approval for, and expanding the uses of, the IFD tax increment financing tool. Currently, IFDs require a two-thirds vote by the affected electorate and are empowered to use tax allocation bonds to finance projects including highways and transit projects; water, flood control, sewer, and solid waste projects; child care facilities, and libraries and parks. The proposed legislation was designed to ease the formation of IFDs by allowing cities or counties that meet specified benchmarks to create these new IFDs and issue related debt, subject to receiving 55 percent voter approval, instead of the current two-thirds vote requirement. The measure would also have broadened allowable projects to include military base reuse, urban infill, transit priority projects, affordable housing, and associated necessary consumer services. The Legislature took no action on the proposal.

Appropriate state versus local funding responsibilities is an issue pertinent to various types of infrastructure (such as local streets and roads, jails, and parks). One consideration is what the ongoing state role should be in funding infrastructure in these areas—weighing such factors as the amount of statewide interest and responsibility in the area, the ability of local agencies to fulfill certain needs without state assistance, and the capacity of the state to fund these needs. The Administration has begun conversations on the responsibility of the state in paying for local infrastructure in two specific areas—school and community college facilities. In addition, the state provides substantial funds for local infrastructure in areas such as streets and transit, resources and environmental protection, and K–12 public schools. In the decade ending in 2010, more than half of the state’s infrastructure spending was administered by local agencies.

The state’s infrastructure comprises both state and local projects. By nature, the decision-making process for many projects is bifurcated and may not necessarily result in a coordinated effort to address infrastructure needs. Depending on the project, this dynamic is not necessarily a negative one. For projects with solely a local impact, local decision-making is appropriate. However, for projects with statewide or regional/local impacts, coordination of state and local efforts is important. State and local governments can work in tandem in order to implement a reasonable infrastructure plan. Without such recognition of joint benefits, projects are likely to be underfunded. To the extent that combined state and local efforts can result in more efficient and integrated systems—particularly in transportation, but also water supply and treatment and natural resources—this can result in maximizing existing resources and investment returns.

The state’s fragmented approach to infrastructure planning and decision-making can be problematic for a number of reasons, but a significant factor is because infrastructure
investments typically involve such large expenditures. Even small state projects costing millions of dollars and bond proposals typically totaling billions of dollars. Furthermore, infrastructure choices have long-term implications as they are often funded with debt that is repaid over 25 or 30 years. This debt is typically repaid using the state’s General Fund, which also funds state programs like education, corrections, and health and human services. Consequently, the funding choices of today have cost implications on the funds available for other state programs for decades.

**ISSUES TO CONSIDER**

Infrastructure is an issue that cuts across various policy areas and includes projects that vary immensely from one another. It can be difficult to know how to best approach it given its scale and complexity. However, infrastructure investment and maintenance is a vital component for the state’s economic health and potential for growth. Unlike some of the state’s past efforts to provide resources to specific industries or sectors—often through preferential tax treatment such as credits or deductions—infrastructure investment cuts across all sectors of the economy and across all regions of the state. An infrastructure investment program can result in higher productivity and increased returns, with positive impacts on employment growth and wages and greater opportunities for California residents. But these benefits can only be maximized if a plan is wisely designed and implemented effectively.

**Infrastructure Goals and Priorities**

A first step for consideration is to identify the state’s overall infrastructure goals. Broad policy goals might include investing in projects that directly affect economic performance such as transportation or improve access to educational opportunities in higher education. Once the goals have identified and articulated, they can be consolidated and evaluated in the context of how they will affect infrastructure decisions. Statewide goals and objectives should drive choices regarding which infrastructure areas or large projects merit particular state focus. Particular projects should be also be considered, compared and prioritized given the level of available resources. Preference may be given to projects or proposals that address broad state goals, reduce future state costs, protect health and safety, fulfill legal requirements, or leverage other funding streams. In addition, the state should consider the importance of return on investment, which will vary from project to project. Clearly, returns should not be the sole criteria, but they should be a component of the overall decision matrix.

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6 See the discussion of tax expenditure programs in the “Taxes and Revenues” section of this report.

7 Economically efficient investments may result in maximizing returns, such as in transportation, but may not result in funding those areas with the most need, such as corrections and rehabilitation. Other investments, such as in courts or education, might represent a mix of maximizing returns and responding to needs.
Coordinating Investment Efforts
The Legislature will also want to consider which needs should be addressed by the state and which should be left to local agencies or private entities. As mentioned previously, given the large scale of the infrastructure needs across the state, it is important for the Legislature to think about the extent to which it can continue to sustain its historical role in funding infrastructure that meets predominately local needs. In addition, state infrastructure proposals are routinely reviewed and funded separately and through differing processes, depending on the circumstances and nature of the specific proposals. While many infrastructure decisions within policy areas are driven by specific programmatic needs, these compartmentalized decision-making processes can also make it difficult to effectively assess—from a statewide perspective—the trade-offs of different projects or proposals across policy areas. There could be better use of regularly updated, centralized compilation and prioritization of projects across programs to better assess the range and scale of the state’s infrastructure needs, as well as to determine its own funding priorities.

Funding and Costs of Infrastructure Investment
The Legislature may also want to consider the appropriate method for funding the state’s infrastructure projects and whether it agrees with the current approach to taking on new General Fund commitments, including debt obligations. Infrastructure spending, whether pay-as-you-go spending or debt-service payments, comes at the expense of spending on other areas. Thus, infrastructure financing choices represent policy trade-offs that the Legislature will have to make. The Legislature may want to explore not only funding approaches, but also the feasibility of other funding sources besides the General Fund, such as special funds and user fees. Given the magnitude of the infrastructure needs, additional revenues—or increases in current revenue streams—should be considered. See the section entitled Transportation for a discussion of these funding options.

Finally, decision-makers will want to consider the ongoing costs associated with projects and proposals. Investments in new infrastructure typically result in ongoing increased operating costs for staffing, utilities, and maintenance of new facilities. For example, additional prison facilities require more correctional officers and inmate health care staff, and the acquisition of park land frequently requires additional park employees to operate and maintain facilities, trails, and roads for public use. On the other hand, some infrastructure investments can actually reduce costs by lowering facility operational costs or enhancing the efficiency of program delivery. For instance, building renovations or replacements can reduce energy use and ongoing maintenance needs, which can result in savings that can partially offset capital costs.
Overview of the 2015-16 Budget

General Government

Taxes and Revenues

BACKGROUND

Revenue Forecast
The Governor and the Legislative Analyst’s Office (LAO) have both forecasted continued economic recovery nationally and in California, as discussed in the Budget Overview. The state’s recovery has continued to gather momentum as a result of better real estate conditions, faster job growth, and improved consumer attitudes. This has resulted in strong revenue growth in the current year, which is expected to continue through the budget year. As noted in the Budget Overview, the state relies on three principal taxes for revenue sources to support the General Fund. In the current year, personal income taxes will contribute about 67 percent, sales and use taxes about 22 percent, and corporation taxes about 9 percent of total revenues. The Administration expects that General Fund tax revenues will end 2014-15 more than $2.0 billion above its projections in last June’s state budget package for the current year. In addition, the Administration projects that the General Fund’s three major taxes collectively will increase by over $5.6 billion in 2015-16, to a level that is more than $1.0 billion above the Administration’s estimates from last June for the 2015-16 fiscal year.

The Administration’s new projections are reflective of recent robust personal income tax and corporation tax collections by the state, including gains in personal income tax withholding and lower than anticipated levels of corporation tax refunds. These gains have more than compensated for the decline in estimated sales and use tax revenues. The LAO notes that after the Administration completed its forecasting exercise, the state experienced a surge in personal income tax revenues (generally from capital gains realizations and business income). This phenomenon has led the LAO to indicate that revenues may well be $1.0 billion to $2.0 billion more than forecast in the current year. Over the three-year period (prior, current and budget years), the Administration’s General Fund revenue forecast is about $3.0 billion higher than LAO’s November estimate—a percentage discrepancy of less than one percent. Recent revenue forecasts are shown in the table presented below:
Overview of the 2015-16 Budget
General Government

General Fund
Recent Revenue Forecasts
(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th>June 2014 Budget Act</th>
<th>November 2014 LAO</th>
<th>January 2015 Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2013-14</strong></td>
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<tr>
<td>Personal Income Tax</td>
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<td>$66,667</td>
<td>$66,560</td>
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<td>Sales and Use Tax</td>
<td>22,759</td>
<td>22,251</td>
<td>22,263</td>
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<td>Corporation Tax</td>
<td>8,107</td>
<td>8,519</td>
<td>8,858</td>
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<td>Other Revenues and Transfers</td>
<td>4,797</td>
<td>4,840</td>
<td>4,992</td>
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<td><strong>Total</strong></td>
<td><strong>$102,185</strong></td>
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<td><strong>$102,675</strong></td>
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<tr>
<td><strong>2014-15</strong></td>
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<tr>
<td>Personal Income Tax</td>
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<td>$72,201</td>
<td>$72,039</td>
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<td>Sales and Use Tax</td>
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<td>23,438</td>
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<td>Corporation Tax</td>
<td>8,910</td>
<td>9,482</td>
<td>9,748</td>
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<td>Other Revenues and Transfers</td>
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<td>3,945</td>
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<td>Transfer to BSA</td>
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<td>-1,606</td>
<td>-1,606</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$105,488</strong></td>
<td><strong>$107,442</strong></td>
<td><strong>$108,042</strong></td>
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<td></td>
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<tr>
<td><strong>2015-16</strong></td>
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<tr>
<td>Personal Income Tax</td>
<td>$74,444</td>
<td>$74,932</td>
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<td>Sales and Use Tax</td>
<td>25,686</td>
<td>24,653</td>
<td>25,166</td>
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<td>Corporation Tax</td>
<td>9,644</td>
<td>10,375</td>
<td>10,293</td>
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<td>Other Revenues and Transfers</td>
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<td>3,412</td>
<td>3,739</td>
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<td>Transfer to BSA</td>
<td>-937</td>
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<td>-1,220</td>
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<td><strong>Total</strong></td>
<td><strong>$112,328</strong></td>
<td><strong>$111,397</strong></td>
<td><strong>$113,380</strong></td>
</tr>
</tbody>
</table>

Source: Legislative Analyst’s Office

Proposition 30 Temporary Taxes
The passage of the temporary taxes in the fall of 2012 gave the state some breathing room in terms of budgetary pressures and also provided an opportunity to evaluate the state’s revenue system and its current structure. Proposition 30 raised tax rates for the personal income tax and the sales and use tax on a temporary basis. The additional revenues are derived from:

- **Personal Income Tax Rates on High Income Taxpayers**—The measure increased personal income tax for high-income taxpayers for seven years, beginning tax year 2012. Under prior law, the maximum marginal personal income rate was 9.3 percent. This measure temporarily raised personal income tax rates for higher incomes by creating three new tax brackets with rates above 9.3 percent. The thresholds noted below are adjusted in subsequent years to account for changes in the cost of living.
A 10.3 percent tax rate on income between $250,000 and $300,000 for individuals and $500,000 and $600,000 for joint filers.

An 11.3 percent tax rate on income between $300,000 and $500,000 for individuals and $600,000 and $1 million for joint filers.

A 12.3 percent tax rate on income in excess of $500,000 for individuals and $1 million for joint filers.

**Sales and Use Tax Rate Increase**—The measure increased the SUT rate by 0.25 percent for four years. The tax increase went into effect January 2013 and will continue through December 2016.

The temporary taxes gradually phase-out over a three year period, beginning in 2016-17 when the sales and use tax increase expires. The impact of the expiration of the personal income tax rate increase occurs in 2018-19. The revenues generated by the Proposition 30 are significant. The impact of these revenues—and their phase-out over the next few years—has wisely been incorporated in the Administration’s long-run fiscal plan. Nevertheless, the impact of these revenues is significant—accounting for forecasted revenues in excess of $8.0 billion in 2015-16, as shown in the table below.

### General Fund
**Proposition 30 Revenue Impacts**
(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>June 2014</strong></td>
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<td></td>
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<tr>
<td>Budget Act</td>
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<tr>
<td>Personal Income Tax</td>
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<td>Sales and Use Tax</td>
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<td><strong>Total</strong></td>
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<td>$7,687</td>
<td>$7,337</td>
<td>$6,878</td>
<td>$2,811</td>
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<tr>
<td><strong>January 2015</strong></td>
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<tr>
<td>Governor’s Budget</td>
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<tr>
<td>Personal Income Tax</td>
<td>$6,458</td>
<td>6,489</td>
<td>6,765</td>
<td>7,132</td>
<td>2,912</td>
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<td>Sales and Use Tax</td>
<td>1,409</td>
<td>1,529</td>
<td>804</td>
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<tr>
<td><strong>Total</strong></td>
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<td>$8,018</td>
<td>$7,569</td>
<td>$7,132</td>
<td>$2,912</td>
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<tr>
<td><strong>Increase over June Forecast</strong></td>
<td>$449</td>
<td>$332</td>
<td>$232</td>
<td>$253</td>
<td>$101</td>
</tr>
</tbody>
</table>

*Source: Department of Finance*

**Tax Administration**

Tax payments and refunds are examined monthly to assess the accuracy of the revenue forecast. The Governor’s budget revenue forecast is the annual starting point; LAO releases an updated revenue forecast in February; the Governor releases an additional revenue forecast with the May Revision; and, LAO typically provides its own update at this time. Finally, the LAO releases a thorough forecast in November each year. Subsequent revenue forecasts benefit from additional months of actual tax collection and
refunds. The State Controller’s Office (SCO) and DOF release updates on tax collection in the first half of each month. General Fund projections displaying point-in-time estimates are provided in the Appendix of this Overview.

Taxes are remitted through different means. Employment wages and bonuses are part of employer personal income tax withholding, which the employer remits to the state, while estimated quarterly payments are required for taxpayers that have capital gains or other significant income outside of wage earnings. The sales and use tax is generally remitted in monthly or quarterly payments by retailers, and is pre-paid by larger retailers. Businesses paying the corporation tax make quarterly tax payments. Tax refunds are also tracked in monthly data for taxpayers who overpaid their tax. The following are some of the key tax dates that occur and inform the budget deliberations:

- **January 15**—Final quarterly estimated payments for personal income taxes are due for the 2014 tax year.
- **January 31**—Final SUT payments are due from retailers for the fourth quarter of 2014.
- **March 15**—Tax filing deadline for those subject to the corporation tax.
- **April 15**—Tax filing deadline for the personal income for the 2014 tax year, and due date for the first quarterly estimated payment for the 2015 tax year. For corporations that use calendar years for reporting, the first quarterly corporation payment is due.
- **April 30**—Final sales and use tax payments are due from retailers for the first quarter of 2015.

**ISSUES TO CONSIDER**

**Proposition 30 Trigger-off**

As noted above, the current year is the penultimate year in which the state receives the full benefits of the revenues generated by the passage of Proposition 30. In budget year plus one, the sales tax increase will end (December 31, 2016) and the cessation of revenues from personal income tax increases will begin in the subsequent year. The Administration has been prescient in structuring its payoff of budgetary borrowing to coincide with termination of the temporary taxes. This will free-up General Fund resources and help in avoiding a ‘fiscal cliff’ due to the cut-off of temporary revenues. Nevertheless, the General Fund operating margins narrow considerably after the temporary taxes end, and in 2018-19 the General Fund operating margin is forecast to be a negative $1.1 billion. (Note that the balance in the BSA is expected to be $6.1 billion at this point.)

The end of the temporary taxes presents questions to the Legislature as to whether additional revenues are necessary beyond the end date of the temporary taxes and—if so—how such revenues should be generated. In recent years, two major analyses of the state’s revenue structure were conducted, one by the “Commission on the 21st Century Economy” (COTCE) in 2009 and the Berggruen Institute “Think Long Committee” (TLC) in 2011. Both analyses recommended a move away from the concentrated reliance
on the income tax and a broadening of the tax base to capture changes in the economy since the state’s tax system was substantially established in 1930s. COTCE recommended an untried and untested business net receipts tax (basically a sub-national value added tax), whereas TLC recommended expanding the existing sales and use tax to encompass services and intangible property. This latter approach is discussed further below.

By moving away from a high reliance on the personal income tax and incorporating a tax approach with a broad base, both COTCE and TLC sought to simultaneously address various perceived drawbacks of the state’s current tax structure—volatility in the state revenue stream, disincentives to investment from high marginal tax rates, an underperforming corporation tax, and distinctions in tax burden for large segments of economic activity. Certainly, expanding the sale and use tax base and a business-based consumption tax are reasonable approaches to addressing some of these issues; however, it is important to note that there are additional means to deal with these concerns. Options could include, for example, reducing or eliminating various tax expenditure programs, as discussed below; reforming aspects of real property taxation, such as altering the reassessment of commercial property; or expanding the fiscal capacity of local governments, either by easing access to existing taxes or expanding the types of taxes than can be levied.

If the Legislature begins to consider the state’s tax structure in this fiscal year and the next, it may want to be mindful of two fundamental concerns:

- **How should the tax burden be distributed?** The type of tax imposed, coupled with the actual tax rate structure, can result in very different impacts on businesses and consumers, labor and owners of capital, and across income groups. Any major tax change will likely have a significant effect on the distributional impacts of taxation.

- **How will the tax system affect economic growth?** Generally, economic considerations would argue for a broad tax base with low rates, as high marginal rates are perceived as detrimental to capital investment.

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1 Property tax revenues remain within the county of the property assessment. Although the proportion going to K-14 education varies from county to county, to the extent that this occurs, it provides an offset to the General Fund obligation for Proposition 98 funding that would otherwise be due, and thus provides a General Fund savings.

2 Who eventually ends up bearing the burden of a tax is quite distinct from who remits the tax. The economic incidence (who bears the economic burden) generally differs from the statutory incidence (who is legally responsible for remitting the tax) because of the ability to shift the tax burden. For example, a tax on business, such as the corporation tax, can be shifted backward—by reducing wages or profits—or forward—by increasing prices. Estimating where the tax actually ‘sticks’ is a complex exercise, and tax incidence can vary dependent on prevailing economic conditions and various market factors. Usually, the burden of the tax is borne by several factors and differentially distributed across the income spectrum.

3 Considering all of its taxes, California’s tax system is generally moderately progressive across most of the income spectrum, in the sense that higher income residents pay proportionately more of their income in taxes than lower income residents.

4 At the National Tax Association 2014 Annual Conference, Nobel Prize-Winner in Economics, Joseph Stiglitz, argued that capital gains—taxed at a preferential rate at the federal level and as ordinary income in
of taxes on economic activity, it is important to weigh all state and local taxes, not just isolated components.

These preeminent considerations may often be in conflict, in the sense that a tax regime that is designed to attract investment is likely to be less progressive and a regime that is highly progressive may be perceived as presenting competitive barriers to economic growth. In addition, the disproportion growth in the share of income that has occurred in recent decades to higher income individuals is an important backdrop to any discussion of tax burden. Most state tax systems are structured to balance various competing considerations. The Legislature is in the position to weigh the proper balance of these concerns, keeping in mind that the tax system is only one consideration—and in a broad sense, a relatively minor one—that businesses and investors weigh in their location or expansion decisions.5

**Tax Expenditure Programs**
The state’s major income taxes incorporate numerous policies that result in special treatment for individuals or businesses, based either on situational factors or for engaging in certain activities. The policies that provide this special treatment are known as tax expenditure programs (TEPs) in the sense that they result in the ‘expenditure’ on a designated program of revenues that would otherwise be received by the state. TEPs largely come in the form of tax credits (a direct reduction in taxes owed) and income deductions (a reduction in income subject to the tax). Certain other TEPs include provisions such as accelerated depreciation, preferential tax rates, income disregards, or similar programs. TEPs result in a substantial reduction in the amount of revenue that would be received by the state absent the program; for TEPs related to income taxes, the LAO and DOF peg the foregone state revenue in most years at about $35 billion.

The TEP construct draws a parallel between direct expenditures of the state on an activity—for example, funds expended for conducting applied research—and the provision of a tax credit to the private sector for engaging in such research activity. Thus, looked at from the taxpayer perspective, elimination of or reductions in TEPs would allow for a broad-based reduction in taxes for all taxpayers while maintaining the same level of revenue. Generally, TEPs are of two types; those that are designed to give taxpayer relief (for example, the dependent exemption credit under the personal income tax) or provide an incentive for certain behavior deemed beneficial (for example, the research and development [R&D] tax credit under the corporation tax and personal income tax).

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5 Economic literature is quite consistent with respect to the importance of various factors in business and investment location and expansion, with such considerations as labor quality, market access, transportation infrastructure, and regulatory environment ranking as more important factors than taxes.
Unlike direct spending, TEPs do not come through the legislative budget process, and thus, are not regularly evaluated as to their appropriateness or effectiveness. Although some TEPs are of limited duration (‘sunsetted’) or limited as to the aggregate amount (‘capped’), TEPs are embodied in the tax code and typically allowed to grow much like an entitlement. Absent a cap or sunset, eliminating or limiting a TEP is generally considered a tax increase. As a result, many TEPs are on the equivalent of ‘automatic pilot.’ One example is the R&D tax credit. Although many economists and tax analysts recognize the value of the R&D tax credit, there has been no methodical evaluation of its effectiveness or efficiency in achieving its designated objective—stimulating additional R&D activity. The credit continues to grow; whereas in 2001-02, the revenue impact of the credit was estimated to be $435 million, in 2015-16, the TEP is expected in a reduction in combined corporation tax and personal income tax revenues of approximately $1.8 billion.

Sales Tax Base and Services
Over the last several decades, the sales and use tax has become increasingly detached from the overall structure of the economy. The sales and use tax—both state and local portions—is levied on the sale of tangible personal property, or goods. Originally intended to approximate a tax on consumption (except food and certain other necessities), a large proportion of personal consumption is now on services and intangibles. To the extent this has occurred, the base of the sales and use tax has become narrower and narrower relative to the underlying economy. This development not only puts upward pressure on tax rates, but also results in economically inefficient distortions.

In addition to this increasingly narrowed base, some suggest that the sales and use tax base could simultaneously be too broad in certain respects, since the sales and use tax is levied not only on the sale of goods to consumers, but also sales to businesses. To the extent that goods sold to businesses are subsequently incorporated in goods that are later sold and themselves subject to the sales and use tax, there is an argument that this results in double taxation—or ‘tax pyramiding.’ Partially to address this issue and provide an investment incentive for certain sectors, the state several years ago had a manufacturing investment credit that was implemented through the state’s income tax programs. More recently, as part of the tax package that eliminated various ineffective enterprise zone tax incentives, the state enacted a partial sales and use tax exemption for capital purchases by manufacturing firms. On the other hand, if subsequent sales are not taxed, it may be appropriate to treat some business purchases as final consumption.

It should be noted that the taxation of business purchases of goods is a substantial portion of the sales and use tax base, representing roughly one-third of the total in recent years. Thus, any measures to address perceived weaknesses or inconsistencies in the sales and use tax base must be mindful of the potentially significant budgetary and fiscal impacts.

6 The enactment last year by the Legislature of the film tax credit imposed a sunset as well as a cap on this allocated credit in order to limit the revenue drain. Program funding is budgeted at $330 million annually for five years.
Revenue Volatility

The personal income tax is a relatively volatile revenue source, in that revenues from this source grow faster than the economy during periods of expansion and decline more rapidly during periods of economic contraction. Because the share of state revenue derived from the personal income tax has increased over the years, this has had the impact of increasing the volatility of the overall tax system. The reasons for personal income tax volatility are several, but generally they relate to the fact that the top income earners that contribute a significant share of personal income tax revenues are taxed at the highest rate and receive a large proportion of their income through capital gains, dividends, bonuses and stock options. The sharp increase in these types of income during good times, and the sharp drop in bad times, leads to a volatile revenue stream.

Volatility creates problems at the state level because it adds substantial complexity and uncertainty to the budgeting process. The sharp drop in revenues beginning in 2008 meant that the Legislature and the Administration had to address frequent revenue shortfalls and adopt multiple mid-year budget adjustments in order to maintain a balanced approach. The volatile nature of the revenue stream complicated this process. In addition, at the location of service delivery—whether at the state or local level—abrupt changes in the level of the resource commitment lead to uncertainty and confusion.

While there has been and always will be some volatility in the state’s tax system, the increasing volatility in the personal income tax is a characteristic that has developed most acutely in the last two decades. The result has generally been tax cuts and program expansions in good times and program cuts couple with occasional tax increases in bad times. Some have proposed altering the tax system itself, to make it inherently less volatile. For example, as noted above, the COTCE report in 2009 proposed adopting a new tax that would more closely reflect the underlying economy, replace the corporation tax, and reduce reliance on the personal income tax. Other more measured approaches have included subjecting volatile components of the personal income tax to a lower tax rate, resulting in less reliance on those sources, but potentially necessitating increases in other taxes.

Since the state also benefits from an ‘elastic’ revenue stream during periods of economic expansion, a more circumspect and consistent approach that would retain these potential revenue benefits involves reserving a portion of revenues received during good years in order to provide for an adequate budget reserve for use during bad years. Revenues equating to amounts received from particularly volatile sources could be designated for this purpose. The voters took a decisive step in this very direction through the passage of Proposition 2, which established a budget reserve partially funded by capital gains related revenues. Alternatively, the LAO has suggested that the Legislature might earmark such volatile revenues for one-time expenditures, thus avoiding long-term budgetary commitments.
General Obligation Bonds

BACKGROUND

The state uses general obligation bonds (GO bonds) to borrow funds for spending—primarily for infrastructure and other capital investments. The use of bonds to accelerate capital projects is a commonly-used practice of government entities. Bonds must be approved by voters and bond proceeds are either continuously appropriated (immediately available for expenditure) or require an appropriation from the Legislature. All bond debt service is continuously appropriated and, therefore, not appropriated in the annual budget bill. The state has $79.0 billion in outstanding GO bond debt (including self-liquidating bonds such as the Economic Recovery Bonds [ERBs]). Another $31.7 billion in bonds are authorized, but remain unissued. In most instances, bonds are sold at different lengths of maturity such that repayment is spread over about 30 years. The chart below indicates the authorized, but unissued, reservoir of bonds.

<table>
<thead>
<tr>
<th>Authorized Bond Program</th>
<th>Unissued Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prop 1A of 2008: High-Speed Rail</td>
<td>$9,003</td>
</tr>
<tr>
<td>Prop 1 of 2014: Water Quality, Supply, and Infrastructure</td>
<td>7,545</td>
</tr>
<tr>
<td>Prop 1B of 2006: Transportation</td>
<td>4,585</td>
</tr>
<tr>
<td>Prop 84 of 2006: Safe Drinking Water</td>
<td>2,826</td>
</tr>
<tr>
<td>Prop 1E of 2006: Disaster Prep and Flood Prevention</td>
<td>1,719</td>
</tr>
<tr>
<td>Prop 71 of 2004: Stem Cell Research</td>
<td>1,340</td>
</tr>
<tr>
<td>Prop 46 of 2002 &amp; Prop 1C of 2006: Housing</td>
<td>1,201</td>
</tr>
<tr>
<td>Prop 55 of 2004 &amp; Prop 1D of 2006: Education Facilities</td>
<td>803</td>
</tr>
<tr>
<td>All other</td>
<td>2,684</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$31,706</strong></td>
</tr>
</tbody>
</table>

The state generally goes to market to sell GO bonds twice annually—once in the spring and once in the fall. Bond structures are often tailored to meet market demand and investor appetite. This tailoring includes tinkering with variables such as fixed and variable rates, call features and premiums, and various security enhancements. Bonds are sold in amounts necessary to meet expenditure needs, plus an additional cash cushion to account for flexibility regarding how fast projects will expend funds and uncertainty about the timing of the next bond sale. As of November 2014, there is about $4.0 billion in bond cash on-hand, as shown in the following table. This amount includes the fall 2014 bond sales of approximately $1.7 billion of new money, which the agencies would not yet have had time to spend.
General Obligation Bonds Current Cash Proceeds
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Authorized Bond Program</th>
<th>Bond Proceed Cash Remaining as of Nov 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prop 1B of 2006: Transportation</td>
<td>$1,536</td>
</tr>
<tr>
<td>Prop 1E of 2006: Disaster Prep and Flood Prevention</td>
<td>569</td>
</tr>
<tr>
<td>Prop 50 of 2002: Water Security</td>
<td>314</td>
</tr>
<tr>
<td>Prop 1A of 2008: High Speed Rail</td>
<td>265</td>
</tr>
<tr>
<td>Prop 1D of 2006: Public Education Facilities</td>
<td>227</td>
</tr>
<tr>
<td>Prop 13 of 2000: Safe Drinking Water</td>
<td>197</td>
</tr>
<tr>
<td>Prop 84 of 2006: Safe Drinking Water</td>
<td>195</td>
</tr>
<tr>
<td>Prop 1C of 2006: Housing</td>
<td>184</td>
</tr>
<tr>
<td>Prop 71 of 2004: Stem Cell Research and Cures Bond</td>
<td>120</td>
</tr>
<tr>
<td>All others</td>
<td>416</td>
</tr>
<tr>
<td>Total</td>
<td>$4,023</td>
</tr>
</tbody>
</table>

GOVERNOR’S PROPOSAL

General Obligation Bonds and Debt Service
Expenditure of bond proceeds is reflected in the budgets of individual departments, with the payment of bond debt service consolidated in Item 9600 in the Governor’s budget. It is the repayment of bond debt that is reflected as a General Fund expense. Some bond costs are offset by special funds or federal funds. Other bonds are ‘self-liquidating,’ or have their own dedicated revenue. For example, the ERBs receive a quarter-cent of the sales tax as a component of the ‘triple flip’ enacted as part of the 2004 budget package. Once the ERBs are paid off, largely in the current year, as proposed in the Governor’s budget, sales tax resources dedicated to General Fund bond repayment would be freed up.

The Governor’s budget includes $5.4 billion in General Fund costs for GO bond debt service and related costs. (As mentioned earlier, most of the remaining cost of the ERBs is expected to be paid in 2014-15 by making a payment of $3.9 billion. There may be a much smaller payment of $132 million in early 2015-16 to pay off the loans.) In addition, $1.2 billion in debt costs are scheduled to be funded from special funds. Finally, federal bond subsidies, through the Build America Bonds (BABs) program, will provide $326 million in 2015-16, allowing for a reduction in General Fund expenses. The Governor’s proposed budget includes $114.6 billion in General Fund for debt service (not including carry-over balances and the transfer to the rainy day fund), so the net General Fund bond debt service as a percentage of General Fund resources is about 5.0 percent.
## Governor’s Budget for General Obligation Bond Debt

(Dollars in Millions)

<table>
<thead>
<tr>
<th>Category</th>
<th>2013-14 Actual Cost</th>
<th>2014-15 Estimated Cost</th>
<th>2015-16 Forecasted Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund Cost</td>
<td>$4,798</td>
<td>$5,091</td>
<td>$5,377</td>
</tr>
<tr>
<td>Other Funds Cost</td>
<td>1,050</td>
<td>1,076</td>
<td>1,195</td>
</tr>
<tr>
<td>Federal Subsidy (Build America Bond Program)</td>
<td>326</td>
<td>326</td>
<td>326</td>
</tr>
<tr>
<td><strong>Total Debt Service</strong></td>
<td><strong>$6,174</strong></td>
<td><strong>$6,493</strong></td>
<td><strong>$6,898</strong></td>
</tr>
<tr>
<td>Economic Recovery Bonds (ERBs, not included above because indirect GF cost)</td>
<td>$1,538</td>
<td>$3,931</td>
<td>$132</td>
</tr>
</tbody>
</table>

The budget plan includes an assumption that $2.0 billion in GO bonds will be sold in the spring of 2015, and that $1.6 billion more will be sold in the fall of 2015. Among these planned sales are $1.8 billion for transportation and related capital facilities, $800 million for various natural resources bonds, $421 million related to housing bonds, and $346 million for various education facility bonds.

### ISSUES TO CONSIDER

#### Budget and Bonds

Paying GO bond debt is a significant General Fund expense. State and federal tax exemptions for interest income received by investors ensure that GO bond debt is a low-cost financing alternative. To the extent bond costs do not exceed a government’s long-term ability to fund other commitments; bonds allow the public to enjoy the benefits of infrastructure investment more quickly than would otherwise be the case. The LAO indicates that the state’s debt service requirements for infrastructure for bonds already sold will remain under six percent of General Fund revenues over the next several years, and cost roughly $6 billion annually over the same time period. (This does not include the full costs of Proposition 1, water bond sales, which will occur over a number of years.)

Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. During difficult budget times, such as the recent great recession, bonds enable the state to invest in infrastructure while the need for economic stimulus is most acute, borrowing costs are low, and construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. Assuming that a bond carries an interest rate of five percent, the cost of paying it off with level payments over 30 years is close to $2 for each dollar borrowed—$1 for repaying the amount borrowed and close to $1 for interest. This cost, however, spread over a 30-year period, after adjusting for inflation is considerably less—about $1.30 for each $1 borrowed. That bond cost crowds out alternative expenditures over the life of the bond. The Legislature can prioritize or limit bond funding through the budget process as
overall expenditures are prioritized. This question may be particularly acute as interest costs climb as a result of increased demand for capital.

**Bond Management**
As the state’s cash situation deteriorated with the most recent recession, the Administration changed the methodology for managing bond cash. Prior to the recession, reserve cash funded project costs in advance of bond sales, and then bond sales replenished cash reserves. When reserve cash declined, the state had to instead sell bonds in advance of expenditures. Due to project expenditures occurring slower than anticipated at the time of bond sales, large bond cash balances developed—about $9.7 billion as of December 2011. As a result, the Administration implemented a plan to utilize commercial paper to aid cash flow, and reduce the need to carry large bond cash balances. The Administration also requires GO bond programs to demonstrate an immediate need for additional bond proceeds prior to issuing new bonds. Progress has been made to reduce bond cash, and cash reserves have dropped to just under $2 billion by the end of November 2014, excluding the recent fall 2014 GO bond sales. At budget hearings, the Administration could be asked to discuss their management of bond proceeds, forecasts of project expenditures, and the optimal level of cash balances.
Debt and Liabilities

BACKGROUND

Through budget actions over the last decade, the state has borrowed from special funds and deferred various payments to schools in order to help balance the state budget. By the close of 2010-11, the Department of Finance (DOF) indicates that a total of $34.7 billion in loans and deferrals had accumulated and remained unpaid. This amount largely represents the debt overhang from prior year budgets adopted under the previous Administration and is often referred to as the “wall of debt”. By the beginning of 2015-16, this amount is expected to be reduced to $12.9 billion.

Some obligations included in the “wall of debt” have required repayment in specified years due to constitutional requirements or due to scheduled bond debt service. Other debt payments are more flexible and can be repaid over time as the budget situation allows, such as school payment deferrals, and as long as borrowing does not interfere with the activities that a special fund loan supports. The General Fund is typically used to pay off budgetary debt.

In addition to the “wall of debt” the state has accumulated liabilities for retirement costs for state employees, teachers, judges, and University of California employees. These liabilities total $221.6 billion at the start of 2015-16. Some of these unfunded liabilities are being addressed with routine annual payments over time.

Proposition 2, passed by the voters in November 2014 changes the way the state pays down debt and liabilities and saves money in reserves. According to the Legislative Analyst’s Office, Proposition 2 could result in roughly $15 to $20 billion being used to pay down certain state debts. Choices about how calculations are made under Proposition 2 determine the amount of funds that will be split evenly between the rainy-day reserve or paying down debt.

Both the state’s debts and liabilities represent budget challenges, as payments on these restrict legislative discretion and displace funding for ongoing or expanded program costs.

GOVERNOR’S PROPOSAL

Under the Administration’s calculations, Proposition 2 captures a total of $2.4 billion in the budget year. Proposition 2 requires that this amount be split evenly between paying down existing state debt and the reserve. As shown in the figure below, the Governor proposes to spend the required $1.2 billion on paying down $965 million in special fund loans and $256 million in prior-year Proposition 98 costs known as “settle up”. In addition, the Governor’s multi-year budget plan proposes to fully repay special fund loans and settle up costs by the end of 2018-19. Additional detail is provided in the Appendix to this Overview.
## Governor’s Proposal for Debt and Liabilities Payment
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Debt (old “wall of debt”)</th>
<th>Amount Beginning of 2015-16</th>
<th>Prop 2 Eligible</th>
<th>Payment in 2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans from special funds</td>
<td>$3,028</td>
<td>Yes</td>
<td>$965</td>
</tr>
<tr>
<td>Underfunding Prop 98- settle up</td>
<td>1,512</td>
<td>Yes</td>
<td>256</td>
</tr>
<tr>
<td>Unpaid mandate claims for local governments</td>
<td>257</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>Deferred payments to CalPERS</td>
<td>530</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>Unpaid costs to schools and community colleges for state mandates</td>
<td>4,219</td>
<td>No</td>
<td>196</td>
</tr>
<tr>
<td>Prop 98 Williams settlement</td>
<td>273</td>
<td>No</td>
<td>273</td>
</tr>
<tr>
<td>Deferred Medi-Cal costs</td>
<td>2,227</td>
<td>No</td>
<td>_</td>
</tr>
<tr>
<td>Deferral of state payroll costs from June to July</td>
<td>783</td>
<td>No</td>
<td>_</td>
</tr>
<tr>
<td>Borrowing from Transportation Funds (Prop 42)</td>
<td>84</td>
<td>No</td>
<td>84</td>
</tr>
<tr>
<td><strong>Subtotal Debt</strong></td>
<td><strong>12,913</strong></td>
<td></td>
<td><strong>1,774</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>State retiree health</td>
<td>71,773</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>State employee pensions</td>
<td>49,978</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>Teacher pensions</td>
<td>74,374</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>Judges' pensions</td>
<td>3,371</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>University of California (UC) employee pensions</td>
<td>7,633</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td>UC retiree health</td>
<td>14,519</td>
<td>Yes</td>
<td>_</td>
</tr>
<tr>
<td><strong>Subtotal Liabilities</strong></td>
<td><strong>221,648</strong></td>
<td></td>
<td>_</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>$234,561</strong></td>
<td></td>
<td><strong>$1,774</strong></td>
</tr>
</tbody>
</table>
The special fund loans that would be repaid under the Governor’s proposal are shown in the figure below.

### Governor’s Proposal for Repayment of Special Fund Loans
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment Compensation Disability Fund</td>
<td>$303.5</td>
</tr>
<tr>
<td>Motor Vehicle Account</td>
<td>300.0</td>
</tr>
<tr>
<td>State Courts Facility Construction Fund</td>
<td>220.0</td>
</tr>
<tr>
<td>Electronic Waste Recovery &amp; Recycling Account</td>
<td>27.0</td>
</tr>
<tr>
<td>Vehicle Inspection Repair Fund</td>
<td>25.0</td>
</tr>
<tr>
<td>Hazardous Waste Control Account</td>
<td>13.0</td>
</tr>
<tr>
<td>California Health Data and Planning Fund</td>
<td>12.0</td>
</tr>
<tr>
<td>Off–Highway Vehicle Trust Fund</td>
<td>11.0</td>
</tr>
<tr>
<td>Contingent Fund of the Medical Board of California</td>
<td>10.0</td>
</tr>
<tr>
<td>Enhanced Fleet Modernization Subaccount</td>
<td>10.0</td>
</tr>
<tr>
<td>Board of Registered Nursing Fund, Professions and Vocations Fund</td>
<td>8.3</td>
</tr>
<tr>
<td>Dealers’ Record of Sale Special Account</td>
<td>6.5</td>
</tr>
<tr>
<td>Accountancy Fund</td>
<td>6.0</td>
</tr>
<tr>
<td>Private Security Services Fund</td>
<td>4.0</td>
</tr>
<tr>
<td>Debt and Investment Advisory Commission Fund</td>
<td>2.0</td>
</tr>
<tr>
<td>Debt Limit Allocation Committee Fund</td>
<td>2.0</td>
</tr>
<tr>
<td>Physical Therapy Fund</td>
<td>1.5</td>
</tr>
<tr>
<td>Behavioral Science Fund</td>
<td>1.2</td>
</tr>
<tr>
<td>Illegal Drug Lab Cleanup Account</td>
<td>1.0</td>
</tr>
<tr>
<td>Speech–Language Pathology and Audiology Fund</td>
<td>0.5</td>
</tr>
<tr>
<td>Driving–Under–The–Influence Program Licensing Trust Fund</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$964.8</strong></td>
</tr>
</tbody>
</table>

### ISSUES TO CONSIDER

The Governor has prioritized using Proposition 2 funds to pay off special fund loans and prior-year Proposition 98 settle up obligations. However, alternative uses of these funds could pay down certain liabilities faster or potentially free up General Fund dollars for other purposes. For example, the Governor, in his budget, highlighted the $72 billion unfunded liability for retiree health care costs and described a plan largely reliant upon employee bargaining to eliminate the
liability in about 30 years. The Administration could have used a portion of the Proposition 2 funds to pay down some of the retiree health care unfunded liability. Alternatively, Proposition 2 funds could be used to pay off liabilities that the Governor proposes to pay off using General Fund dollars, such as some of the California State Teachers Retirement System (CalSTRS) liability.

In addition, the state could pay off more or less special fund loans now than the Governor proposes. Some of the loan repayments proposed are necessary, some of the loans could be repaid to help meet the desired program objectives, and some repayments are unnecessary to make at this time, as the programs have been operating for many years without the funds.
Cash Management

BACKGROUND

The state’s receipts and disbursements of cash occur unevenly throughout the fiscal year. As a consequence, the General Fund borrows for cash flow purposes in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Given that the state receives revenues on an uneven basis throughout the year, the state’s cash position varies. Maintaining an adequate cash balance by using both internal and external borrowing, allows the state to pay its bills in a timely fashion. Interest is paid on internal borrowing (such as cash flow loans from special funds) and external borrowing (such as Revenue Anticipation Notes [RANs]). For the current year, the state issued a RAN in September of 2014 of $2.8 billion. The RAN is payable in June 2015 and carries an expected interest cost of $20 million.

Total monthly borrowable internal resources from some 700 plus funds are typically in the range of $20 billion. The state also established a new cash flow tool in the form of the Voluntary Investment Program (VIP) in 2012. This measure provided an additional means to assure cash flow continuity by establishing a new account for voluntary participation by local governments. Another cash management tool of the state is the State Agency Investment Fund (SAIF), which attracts deposits from entities not otherwise required to deposit funds with the state. The VIP and SAIF were not used in the current year.

An additional tool in managing cash is deferrals of payments within the fiscal year to K-12 and higher education, local governments, and other entities. In recent years, flexible deferrals have been enacted in statutes that allow specified deferrals, if necessary to maintain a prudent balance for bond debt and other priority payments. The 2014-15 budget included a statutory provision providing that any increases in the Proposition 98 minimum guarantee first be used to pay down late payments to schools and community colleges. For the current year, there were deferrals allowed for K-12 education, higher education, and local government payments. The fiscal impact of these deferrals varies from entity to entity, depending upon their own cash positions.

GOVERNOR’S PROPOSAL

The Governor’s budget does not anticipate engaging in external borrowing (RAN) in 2015-16 and assumes that internal borrowing will be adequate to cover the low points in the state’s cash position. The budget reflects the state’s improved cash position and, if projections hold, would be only the second year since the mid-1980 that the state has not issued a RAN. Given the improvement in the cash status, no new education or other payment deferrals are incorporated in the budget. Based on the cash flow statements of the Administration, the cash low points will occur in December, and March, when unused borrowable cash resources are estimated to be $9.5 billion and $8.9 billion, respectively. By way of comparison, and reflective of the uneven flow of receipts and disbursements, the cash and borrowable resources in June of the budget year are estimated to be $24.2 billion.
Cash flow Borrowing
The state anticipates engaging in its typical internal cash-borrowing, with all internal cash flow borrowing managed such that the programs supported by these special funds are completely unaffected. The budget includes $20 million for internal borrowing costs. As mentioned earlier, the Administration has not proposed a RAN. However, the budget includes $20 million for RAN costs, which the Legislature can delete if the state does not need to borrow externally. There is no anticipated need for the VIP or the SAIF in the Governor’s Budget.

Payment Deferrals and Smoothing
Consistent with law enacted as part of the 2014-15 budget, the Governor’s budget proposal includes $992 million to eliminate all remaining school and community colleges deferrals. In addition, the Administration has not incorporated any new deferrals as part of the budget plan. However, there is the continuation of a $500 million within-the-year deferral to UC and a deferral of up to $250 million of CSU’s annual General Fund appropriation. In addition, the Governor’s budget assumes the continuation of smoothing of payments to UC and CSU that have been carried out in recent years. The continuation of this policy, proposed for budget bill language, would smooth payments over ten months with the remaining amount owed remitted in the final two months of the year.

ISSUES TO CONSIDER
Maintaining an emphasis on cash flow borrowing from special funds is good fiscal policy that reduces the need for more expensive external borrowing. Cash deferrals to other government units are generally among the least desirable of the cash management tools, in that these can cause cash flow stress on other governmental entities. Although this may have been necessary in the past—especially in order to limit the magnitude of external borrowing—not having to rely on this measure in the coming year is positive. The Administration’s proposal appears to be a suitable approach to cash flow management and the lack of external borrowing reflects the state’s overall improved fiscal health.
SUBCOMMITTEE NO. 5

CORRECTIONS, PUBLIC SAFETY,
AND THE JUDICIARY

Corrections and Public Safety
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Judiciary
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BACKGROUND

Over the past few decades, state prisons have increasingly become mental health treatment facilities. Data suggests that the number of people with mentally illness in prison has almost doubled in the last 15 years. Currently, 45 percent of inmates have been treated within the last year for a severe mental illness.

How Did Prisons Become Mental Health Service Providers? Prior to 1957, mental health services were delivered to some persons with serious mental illness by a state-operated and funded institutional system, which included state hospitals for persons with mental illness and two state hospitals serving persons with mental illness and/or a developmental disability.

In 1957, the California legislature passed the Short-Doyle Act in response to the growing number of people with mental illness being confined in public hospitals, many of whom were institutionalized inappropriately or subject to abuse while residing in a state facility. The Act, which provided state funds to local mental health service delivery programs, was developed to address concerns that some individuals with mental illness were better served by local, outpatient services rather than 24-hour hospital care. Lawmakers believed that local programs would allow people with mental illnesses to remain in their communities, maintain family ties, and enjoy greater autonomy. When first enacted, the Short-Doyle Act provided state funding for 50 percent of the cost to establish and develop locally administered-and controlled community mental health programs.

In 1968, the legislature passed the Lanterman-Petris-Short Act (LPS), which further reduced the population of state mental health hospitals by requiring a judicial hearing prior to any involuntary hospitalization. The LPS also initiated increased financial incentives for local communities to take on the provision of mental health services. As a result of this long-term transfer of state operation and oversight to a decentralized, community-based mental health care delivery model, the state mental health hospital population declined from 36,319 in 1956 to 8,198 in 1971. Three public mental hospitals closed during this time period. The Legislature intended for savings from these closures to be distributed to community programs. However, in 1972 and 1973 then-Governor Ronald Reagan vetoed the transfer of these funds. ¹

Throughout the 1970s and 1980s counties contended that the state was not providing adequate funds for community mental health programs. In addition, several counties were receiving less funds on a population basis than other counties. This disparity was addressed, with varying levels of success, in both the 1970s and the 1980s with the allocation of “equity funds” to certain counties. Realignment of mental health programs, enacted in 1991, has made new revenues

¹Historical background from The Stanford Law School Three Strikes Project, “When Did Prisons Become Acceptable Mental Healthcare Facilities?”

Senate Committee on Budget and Fiscal Review
available to local governments for mental health programs, but, according to local mental health administrators, funding continued to lag behind demand.\(^2\)

In the past decade, however, California has made a significant investment in community mental health treatment funding. In November 2004, California voters approved Proposition 63, also known as the Mental Health Services Act. Proposition 63 provides state funding for certain new or expanded mental health programs through a personal income tax surcharge of one percent on the portion of a taxpayer’s taxable income in excess of $1 million. Revenues generated by the surcharge are dedicated to the support of specified mental health programs and, with some exceptions, are not appropriated by the Legislature through the annual budget act. Full-year annual Proposition 63 revenues to date have ranged from about $900 million to $1.5 billion, and could vary significantly in the future. Between 2004-05 and 2013-14, the fund has collected over $11 billion for local mental health services.\(^3\)

Proposition 63 funding is generally provided for five major purposes: (1) expanding community services, (2) providing workforce education and training, (3) building capital facilities and addressing technological needs, (4) expanding prevention and early intervention programs, and (5) establishing innovative programs.

In 2013, the federal Patient Protection and Affordable Care Act (ACA) (health care reform) significantly increased access to private and public health care coverage including mental health services. Included in this was the expansion of Medi-Cal coverage to adults with incomes up to 138 percent of FPL. (Generally, these are childless adults who are nonelderly and nondisabled.) Under the ACA, the federal government will pay for 100 percent of the costs for this population for the first three years (2014-2016) with funding gradually decreasing to 90 percent in 2020. Allowing single, childless adults to receive Medi-Cal should significantly increase access to mental health services for those adults who would otherwise only have access through public county services or the criminal justice system.

The Legislature also passed the Investment in Mental Health Wellness Act (SB 82 (Senate Budget and Fiscal Review Committee), Chapter 34, Statutes of 2013). The bill authorized the California Health Facilities Financing Authority (CHFFA) to administer a competitive selection process for capital capacity and program expansion to increase capacity for mobile crisis support, crisis intervention, crisis stabilization services, crisis residential treatment, and specified personnel resources and the budget provided $142 million General Fund for those grants. In addition, the bill implemented a process by which the Mental Health Services Oversight and Accountability Commission (MHSOAC) allocates funding for triage personnel to assist individuals in gaining access to needed services, including medical, mental health, substance use disorder assistance and other community services. The 2013-14 budget provided $54 million ($32 million MHSA State Administrative Funds and $22 federal funds) in on-going funding for this purpose.

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\(^2\) Legislative Analyst’s Office “Major Milestones: 43 Years of Care and Treatment of the Mentally Ill”, March 2, 2000.

\(^3\) Mental Health Service Act (MHSA) – Revenue Summary, January 2015
Currently, due to the expansion of Medi-Cal eligibility, the state has greatly increased its efforts to assure that anyone leaving prison or county jail is enrolled in Medi-Cal and has access to necessary health care services, including mental health treatment.

**Ralph Coleman, et al. v. Edmund G. Brown Jr, et al.** Primarily because the prison system was severely overcrowded and the provision of mental health treatment was significantly lacking for inmates in need, a class action suit was filed in the United States District Court in 1991 arguing that prisoners with mental illness were subjected to cruel and unusual punishment, a violation of the inmates eighth amendment protections.

In order to find in favor of the plaintiffs, the court needed to determine that the violations were both objective and subjective in nature. In order to meet the objective standard, the court must find that the deprivations were sufficiently serious to constitute the unnecessary and wanton infliction of pain. For the subjective standard, the courts must find that the treatment constituted deliberate indifference, was wanton and showed a pattern of being malicious and sadistic.

In 1995, a district court found that current treatment for mentally ill inmates violated those inmates’ eighth amendment protections and found “overwhelming evidence of the systematic failure to deliver necessary care to mentally ill inmates” who, among other illnesses, “suffer from severe hallucinations, [and] decompensate into catatonic states.” Although a special master was appointed by the court to oversee implementation of a remedial plan, the situation continued to deteriorate, according to periodic reports from the special master. 425 years after the federal suit was filed, the state remains under the control of the federal court in *Coleman v. Brown* and is under regular review and oversight by the special master.

In the original ruling, the court identified six areas in which CDCR needed to make improvements: mental health screening, treatment programs, staffing, accurate and complete records, medication distribution and suicide prevention. In subsequent rulings, the courts expanded the areas of concern to include use of force and segregation policies. In addition, the courts also required that condemned inmates in San Quentin State Prison have access to inpatient, acute-care treatment.

On the following page is a detailed timeline of the major events related to *Coleman v. Brown* over the last 25 years.

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### Major Milestones in the Coleman v. Brown case

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>The Coleman class-action lawsuit was filed in U.S. District Court, Eastern District, alleging that mental health care in state prisons violated the Eighth Amendment’s ban of cruel and unusual punishment.</td>
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<tr>
<td>1995</td>
<td>The Coleman court found that the State was deliberately indifferent to the mental health needs of inmates in violation of the Eighth Amendment. A special master was appointed.</td>
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<tr>
<td>1997</td>
<td>The Coleman court approved a plan to address the inadequacies in mental health care.</td>
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<tr>
<td>2006</td>
<td>Plaintiffs in the Plata and Coleman cases requested the convening of a Three-Judge Panel to review whether overcrowding was the primary cause of the failure to provide adequate medical and mental health care.</td>
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<tr>
<td>2008</td>
<td>The Three-Judge Panel trial took place.</td>
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<tr>
<td>2010</td>
<td>The Three-Judge Panel ordered the State to reduce its adult institution population to 137.5 percent of design capacity within two years and according to a schedule of four benchmarks at six-month intervals. The State appealed to the U.S. Supreme Court.</td>
</tr>
<tr>
<td>2011</td>
<td>In April, Public Safety Realignment (AB 109 (Committee on Budget) Chapter 15, Statutes of 2011), designed to bring about a significant reduction in the prison population, was enacted. It eventually reduced the adult institution population by 25,000.</td>
</tr>
<tr>
<td>2011</td>
<td>In May, the U.S. Supreme Court affirmed the Three-Judge Panel’s order.</td>
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<tr>
<td>2013</td>
<td>In January, Governor Brown filed a motion to terminate the Coleman lawsuit and to end the requirement to reduce the prison population to 137.5 percent of design capacity. The Coleman court denied this motion.</td>
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<tr>
<td>2013</td>
<td>In May, the plaintiffs filed a motion in court alleging the unconstitutional use of force and an inadequate discipline process against the Coleman class members.</td>
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<tr>
<td>2013</td>
<td>In July, the court ordered the special master to monitor the psychiatric programs run by the Department of State Hospitals, particularly in regards to the adequacy of staffing and the use of handcuffs at all times for patients who are out of their cells.</td>
</tr>
<tr>
<td>2013</td>
<td>In December, the court ordered the state to develop a long-term solution for providing inpatient care for condemned inmates currently housed on California's death row.</td>
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<tr>
<td>2014</td>
<td>In April, the Coleman court ruled that California's use of force and segregation of mentally ill inmates violated the inmate's 8th amendment rights.</td>
</tr>
<tr>
<td>2014</td>
<td>In May, the Special Master released his report on the adequacy of inpatient mental health care, including the psychiatric programs run by DSH. The special master also filed an assessment of the San Quentin plan to provide inpatient care for condemned inmates and the court provided additional reporting orders.</td>
</tr>
<tr>
<td>2014</td>
<td>In August, the court issued further orders regarding segregation and use of force.</td>
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<tr>
<td>2015</td>
<td>In January, the Governor's budget proposal included a request related to complying with the 2014 court orders. In addition, the Special Master released his report on suicide prevention practices.</td>
</tr>
</tbody>
</table>

Source: Events through April 2013 are from CDCR's May 2013 "Timeline in the Plata (medical care), Coleman (mental health care) and Three-Judge Panel (prison crowding) cases"
State Prison Population. The California Department of Corrections and Rehabilitation (CDCR) is responsible for the incarceration of the most serious and violent adult felons, including the provision of training, education, and health care services. As of January 21, 2015, CDCR housed about 133,000 adult inmates in the state’s 34 prisons and 42 fire camps. Almost 114,000 of those inmates are in state prisons, which results in those institutions currently being at 137.5 percent of their design capacity. Approximately 9,000 inmates are housed in out-of-state contracted prisons, 6,000 are housed in in-state contracted facilities, and 6,000 are housed in fire camps. CDCR also supervises and treats about 43,000 adult parolees. Approximately 45 percent of those inmates have been treated for severe mental illnesses within the last year.

The Coleman Class. As of January 19, 2015, there are currently 37,829 inmates in the Coleman Class (35,472 men and 2,357 women). According to a December 24, 1998 court ruling on the definition of the class, the plaintiffs’ class consists of all inmates with serious mental disorders who are now, or who will in the future be, confined within CDCR. A “serious mental disorder” is defined as anyone who is receiving care through CDCR’s Mental Health Services Delivery System (MHSDS).

MHSDS provides four levels of care, which depend on the severity of the mental illness. The first level, the Correctional Clinical Case Management System (CCCMS), provides mental health services to inmates with serious mental illness with “stable functioning in the general population, an administrative segregation unit (ASU) or a security housing unit (SHU)” whose mental health symptoms are under control or in “partial remission as a result of treatment.” As of January 19, 2015, 30,065 mentally ill inmates were at the CCCMS level-of-care.

The remaining three levels of mental health care are for inmates who are seriously mental ill and who, due to their mental illness, are unable to function in the general prison population. The Enhanced Outpatient Program (EOP) is for inmates with “acute onset or significant decompensation of a serious mental disorder.” EOP programs are located in designated living units at “hub institution[s].” As of January 19, 2014, 6,044 inmates with mental illness were receiving EOP services and treatment.

Mental Health Crisis Beds (MHCBs) are for inmates with mental illness in psychiatric crisis or in need of stabilization pending transfer either to an inpatient hospital setting or a lower level-of-care. MHCBs are generally licensed inpatient units in correctional treatment centers or other licensed facilities. Stays in MHCBs are limited to not more than ten days. Currently, there are 389 inmates receiving this level-of-care.

Finally, several inpatient hospital programs are available for class members who require longer-term, acute care. These programs are primarily operated by the Department of State Hospitals (DSH), with the exceptions of in-patient care provided to condemned inmates and to female inmates. There are three inpatient psychiatric programs for male inmates run by DSH that are on the grounds of state prisons. Those programs are DSH-Stockton, on the grounds of the Correctional Healthcare Facility; DSH-Vacaville, on the grounds of Vacaville State Prison; and DSH-Salinas Valley, on the grounds of Salinas Valley State Prison. There are currently approximately 1,000 patients in those facilities and the DSH budget for those inmates is approximately $245 million General Fund per year. As of January 19, 1,331 inmates were
receiving inpatient care, 47 of those patients were women and 34 were condemned inmates housed at San Quentin State Prison.

In addition to the patients in the prison-based psychiatric programs, approximately 250 Coleman class inmates are receiving care at Atascadero State Hospital and Coalinga State Hospital. The DSH budget for those patients is $52 million General Fund per year.

**Recent Special Master Report Highlights.** As part of the ongoing court oversight, the special master has issued three key reports in the last year: (1) a report to the court on the adequacy of mental health care for CDCR inmates housed in inpatient, long-term, acute care beds; (2) an assessment of CDCR’s plan to create long-term, acute care beds for inmates housed on death row at San Quentin; and, (3) an audit of suicide prevention practices within the state prisons.

**Adequacy of Inpatient Mental Health Care.** This report found it difficult to assess the overall quality of care provided to inmates in programs run by DSH because the six inpatient programs varied widely in their policies, practices and operations in nearly every aspect of inpatient mental health care administration and delivery. This criticism is not unlike other criticisms raised about the five state hospitals run by DSH. Each appears to function largely autonomously, without consistent policies and practices.

The report noted, “from facility to facility, the special master found difference with seemingly no discernable semblance of coordination and consistency among any of the DSH programs.” At five of the six facilities, the report found that staffing was inadequate, especially the staffing of psychiatrists. The only program found to be adequately staffed was the facility for female inmate-patients at the California Institution for Women (CIW), which is run solely by CDCR.

Given the staffing problems, it was not surprising that the special master also found that inadequate treatment was being provided to patients and that individual therapy was often non-existent. The report noted that as of March 2014, DSH-Vacaville was providing between 1.4 and 4.7 hours per month in out-of-cell and clinical treatment activities. Further, the special master found that even non-therapeutic activities were being credited as an hour of out-of-cell treatment. In addition, at Vacaville, patients complained that they had no one to talk to when they were having problems and that if they asked for individual counseling or therapy sessions, the response was often to provide them with more medication. At DSH-Stockton, patients reported that the facility was considerably more restrictive than the prisons they were transferred from because, similar to a maximum security environment, where they are required to be confined to their rooms 21 to 22 hours per day.

In contrast, CIW provided all of the necessary care for patients in the program including group, individual, and unit activities. The report noted that in January 2014, the patients were offered an average of 15 hours per week of group activities and that nearly all scheduled individual treatment was completed. However, the special master did find that it was difficult to distinguish between intermediate levels-of-care and acute care because the enhanced care required for acute care patients did not appear to be provided. However, compared to the five programs run by DSH for male inmate-patients, the program run by CDCR for female inmate-patients offered significantly more treatment and therapeutic programs.
Inpatient Care for Condemned Inmates at San Quentin State Prison. In this report, the special master’s findings were largely favorable. He found that the assessment of condemned inmates who are mentally ill had been successful and that 37 inmates had been found in need of inpatient care. While work remains on the physical plant changes necessary to activate the facility at San Quentin, the special master commended CDCR for the work that has been achieved so far and urged them to continue along an expedited time-line so that the patients could be appropriately placed in the new facility.

Audit of Suicide Prevention Practices in State Prison. The audit found that the provisions of the Coleman Program Guide on suicide prevention provided reasonable and comprehensive guidelines. However, while the guidelines were deemed to be adequate, the audit found that the suicide prevention practices within the prisons did not follow the guidelines. Despite the guidelines, the number of suicides within the prisons has remained virtually unchanged since 2010 and the rate of suicide is substantially higher than other prison systems throughout the United States. The report noted that the most surprising finding in the audit was that despite the implementation of monitoring practices, comprehensive reviews of each inmate suicide, and other quality improvement practices, many of the deficiencies found by the audits had not been identified in any of the quality improvement activities. For example, correctional officers at various prisons were observed not conducting their required 30-minute rounds in administrative segregation units in a timely manner. In addition, medical staffs responsible for conducting observations of inmates in several MHCB units were observed to be not conducting the rounds at required intervals and then falsifying documentation. While the deficiencies were not found at all 34 prisons, the report notes that to varying degrees, the deficiency were found at most of the prisons. Given the results of the audit, it is possible that the court will be issuing additional orders around the area of suicide prevention.

Recent Coleman Court Orders. On April 14, 2014, Judge Karlton ruled that California continued to violate the constitutional safeguards against cruel and unusual punishment by subjecting inmates with mental illness to excessive use of pepper spray and isolation. He gave the state 60 days to work with the special master to revise their excessive force policies and segregation policies, and to stop the practice of holding inmates with mental illness in the segregation units simply because there is no room for them in more appropriate housing. He also ordered the state to revise its policy for strip-searching inmates with mental illness as they enter and leave housing units. The 60-day deadline for some of the requirements was subsequently extended until August 29, 2014.

The department submitted a revised use of force policy to the courts that limits the use of pepper spray on inmate-patients and revises their cell management strategy. On August 11, 2014, the court accepted the new policies. Among other changes to the policy, correction staff is required to consider an inmate’s mental health prior to using any controlled use of force. That consideration must include the inmate’s demeanor, bizarre behavior status, mental health status, medical concerns and their ability to comply with orders. In addition, a mental health clinician must evaluate an inmate’s ability to understand the orders, whether they are a Coleman class inmate or not. They must also evaluate whether the use of force could lead to a decompensation of the person’s mental health.
On August 29, 2014, the state submitted a plan to comply with the remainder of the April 14 court order and the court accepted the plan. Under this court order, CDCR is required to create specialty housing units for housing inmates with mental illness who are removed from the general population. These specialized units must include additional out-of-cell activities and increased treatment. Under this plan, male inmates in short-term restricted housing will receive 20 hours of out-of-cell time each week, which is twice the amount of time offered to CCCMS inmates in the existing segregation units. Female inmates in short-term housing, however, will only receive 15 hours of out-of-cell time each week, which is 50 percent more than the current ten hours. In the longer-term restricted housing, male and female inmates will be allowed 15 hours a week in out-of-cell time.

The plan also requires that CDCR conduct a case-by-case review of all Coleman class inmates with lengthy segregation terms, in an attempt to decrease the length of stay for inmates in segregated environments. Additionally, the plan establishes a case review for all inmates being released from DSH or CDCR psychiatric inpatient beds who are facing disciplinary terms in segregation to ensure that the inmate is returned to appropriate housing and not to segregation.

In several areas, the plan presented by CDCR extended beyond the court order and included additional training and collaboration between mental health staff and custody staff. The plan also requires custody staff to make security checks on all inmates in specialized restricted housing twice every hour and requires that licensed psychiatric technicians conduct daily rounds to check on every inmate’s current mental health status. The increased checks are designed to reduce suicides and suicide attempts among this population, which have been an ongoing concern of the court. Finally, the plan increases the amount of property allowed for inmates in short-term restricted units. For example, inmates will now be allowed one electrical appliance if their cell allows for it. If it does not, they will be provided with a radio.

**GOVERNOR’S PROPOSAL**

**Proposed Mental Health Budget for Inmate-Patients.** While the exact budget for mental health at CDCR is unknown because pharmaceuticals and non-institution-based administration are budgeted in different items that include other types of costs, the total CDCR mental health budget for 2015-16 is approximately $450 million General Fund. In addition, as noted above, the psychiatric programs run by DSH to treat approximately 1,000 inmate-patients cost approximately $245 million General Fund per year and the cost of the inmate-patients in the state hospitals is over $50 million General Fund annually. Therefore, the General Fund cost for housing and treating inmates with mental illness incarcerated in the state prison system is roughly $745 to $750 million General Fund per year.

**Coleman v. Brown Budget Proposal.** As outlined above, in the past year, the federal court ordered CDCR to make various changes concerning their treatment of certain inmates who are mentally ill. The budget requests $20 million General Fund and 104.8 permanent positions in the current year, and $42 million General Fund and 290.4 permanent positions annually, beginning
in 2015-16, for court-ordered changes to CDCR’s use of force and segregated housing policies. The money is budgeted as shown in the table below:

### 2014-15 Proposed Coleman Positions and Costs
(Dollars in Millions)

<table>
<thead>
<tr>
<th>Positions</th>
<th>Total Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of Force and Cell Management Status</td>
<td>$1.6</td>
</tr>
<tr>
<td>Short and Long Term Housing Units</td>
<td>$5.6</td>
</tr>
<tr>
<td>Non-Disciplinary Segregation</td>
<td>$1.7</td>
</tr>
<tr>
<td>Inmate-Patient Welfare Check System</td>
<td>$5.7</td>
</tr>
<tr>
<td>Monitoring and Oversight</td>
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</tr>
<tr>
<td>Specialized Mental Health Training</td>
<td>$3.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$19.6</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Positions</th>
<th>Total Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of Force and Cell Management Status</td>
<td>$2.7</td>
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<tr>
<td>Short and Long Term Housing Units</td>
<td>$24</td>
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<tr>
<td>Non-Disciplinary Segregation</td>
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<td>Inmate-Patient Welfare Check System</td>
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<tr>
<td>Monitoring and Oversight</td>
<td>$3</td>
</tr>
<tr>
<td>Specialized Mental Health Training</td>
<td>$2.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$42</strong></td>
</tr>
</tbody>
</table>

In addition, the court ordered CDCR to develop a plan to improve the vacancy rate for psychologists, licensed clinical social workers, and psychiatrists. The budget does not include any additional funding to address this issue. Finally, the Governor notes that the Administration is currently considering shifting responsibility for 1,086 inpatient mental health treatment beds from DSH to CDCR. The proposed budget includes $244 million (General Fund) for the three psychiatric programs for prisoners overseen by DSH.
ISSUES TO CONSIDER

How to Improve Our Current System for Treatment and Care of Inmates Who Are Severely Mentally Ill. The Legislature may want to consider the creation of an advisory council, similar to the Child Welfare Council within the Health and Human Services Agency,\(^5\) to bring together nationally recognized experts in mental health and public safety to advise the Administration and the Legislature on the most effective ways to improve our current systems. The council could consider treatment and systems in place in other states and nations to provide recommendations for program and policy changes in areas including, but not limited to, diversion programs, appropriate training for custody staff and law enforcement, appropriate treatment settings, modification of, or alternatives to segregated units, and strategies for keeping patients and staff safe while providing treatment in the least restrictive settings possible. The problems have become so significant for CDCR, DSH, and local communities that, absent clear long-term planning and direction, it is difficult to know where and how to making meaningful improvements.

Independent Oversight of the State Hospital System. The state Inspector General (IG) provides independent oversight over the state prison system. Among other duties, the IG investigates complaints of mistreatment, provides oversight for CDCR’s internal investigations and employee discipline process, conducts medical inspections to review the delivery of medical care to inmates, evaluates the qualifications of all wardens and superintendents, and conducts special reviews at the request of the Speaker of the Assembly or the Senate Rules Committee. However, the jurisdiction of the IG does not include psychiatric programs run by DSH for inmates or any state hospitals.

Given the critical Coleman report on the treatment of patients in the psychiatric programs and the $300 million General Fund spent annually on inmate-patients housed in facilities run by DSH, the Legislature may wish to consider expanding the scope of the IG’s duties to include oversight of over the psychiatric programs or create a similar independent oversight entity with the necessary expertise in the provision of mental health diagnosis and treatment. Expanded and independent oversight would provide the Legislature and the Administration with additional ongoing information concerning the quality and type of treatment provided. In turn, the Legislature and Administration would be able to take steps to improve treatment and outcomes, ensure a better use of the taxpayers’ money, and optimally, see an end to federal court oversight.

\(^5\) The California Child Welfare Council was established by the Child Welfare Leadership and Accountability Act of 2006 (Welfare and Institutions Code Sections 16540 – 16545) and serves as an advisory body responsible for improving the collaboration and processes of the multiple agencies and the courts that serve the children in the child welfare system. The Council is co-chaired by the Secretary of the California Health and Human Services Agency and the designee of the Chief Justice of the California Supreme Court, and membership is comprised of state departments, county departments, nonprofit service providers, advocates, parents and former foster youth. The Council is charged with monitoring and reporting on the extent to which the agencies and courts are responsive to the needs of children in their joint care.
In last year’s budget, in lieu of expanding the role of the current IG or creating a new IG, the Legislature adopted the following report requirement:

*The Secretary of the Health and Human Services Agency shall provide, no later than January 10, 2015, a report, together with specific and detailed recommendations, to the fiscal and appropriate policy committees of the Legislature, reviewing and evaluating the best practices and strategies, including independent oversight, for effectively and sustainably addressing the employee discipline process, criminal and major incident investigations, and the use of force within the Department of State Hospitals. The secretary may consult with the California Highway Patrol, the Department of Corrections and Rehabilitation, the Office of the Inspector General and any other resource identified by the Secretary as valuable to this analysis. It is the intent of the Legislature that this report and set of recommendations reflect a critical and pragmatic analysis of the department’s current practices and policies, and include a set of meaningful recommendations describing how current practices and policies should be revised and reformed to assure safety and accountability in the state hospital system.*

This requirement was intended to further the conversation concerning the need for ongoing, independent oversight and the adoption of uniform policies and practices throughout the state hospital system. To date, the Health and Human Services Agency has not provided the required report.
BACKGROUND

California law identifies three categories of crimes: felonies, misdemeanors, and infractions. A felony is the most serious type of crime, and an individual convicted of a felony may be sentenced to state prison under certain circumstances. Individuals convicted of felonies who are not sentenced to state prison are sentenced to county jail, supervised by the county probation department in the community, or both.

Existing law classifies some felonies as “violent” or “serious,” or both. Examples of felonies currently defined as violent include murder, robbery, and rape. While almost all violent felonies are also considered serious, other felonies are defined only as serious, such as assault with intent to commit robbery. Felonies that are not classified as violent or serious include grand theft (not involving a firearm) and, until the passage of Proposition 47 in November, possession of a controlled substance. In recent years, states have begun reconsidering whether the punishments meted out for various crimes appropriately fit the nature of the crime. Much of this reconsideration came as prisons became overcrowded due to enhanced sentences and as increasingly large portions of state budgets were being dedicated to prison spending.

California’s “Three Strikes” Law. The Three Strikes law, passed in 1994, imposed a life sentence for almost any crime, no matter how minor, if the defendant had two prior convictions for crimes defined as serious or violent by the California Penal Code. Statistics from the California Department of Corrections (CDCR) indicate that the law disproportionately affects minority populations. Over 45 percent of inmates serving life sentences under the Three Strikes law are African-American. The Three Strikes law is also applied disproportionately to defendants with physical or mental disabilities. California's State Auditor estimates that the Three Strikes law adds over $19 billion to the state's prison budget. There has also been widespread criticism that the Three Strikes law has had little, if any, impact on public safety.

According to The Sentencing Project, the United States is the world's leader in incarceration with 2.2 million people currently in the nation's prisons or jails—a 500 percent increase over the past 30 years. This rate of incarceration is far greater than any other industrialized nation and unprecedented throughout the history of the United States. These trends have resulted in prison overcrowding and required states to use increasing shares of their budgets to fund the rapidly expanding penal system.¹ In California alone, the public safety budget has grown from $1 billion in 1984-85, which constituted four percent of the state General Fund budget at the time, to over $11 billion (including realigned revenue) in 2014-15, constituting approximately ten percent of the state’s General Fund budget.

Recent Sentencing Trends. After 30-years of “tough on crime” sentencing, people throughout the country from across the political spectrum have begun rethinking the incarceration of such a

¹ Information on rates of incarceration comes from www.sentencingproject.org.
large percentage of the population in prisons and jails. States, including California, Texas, and New York have found that justice systems focused primarily on punishment rather than treatment and rehabilitation, is not sustainable or necessarily healthy for society. According to a recent New York Times article, experts have found that longer sentences and mandatory minimum sentences, which have been the trend over the last few decades, have had a minimal effect on reducing crime. The critics argue that imprisoning more people for long periods of time does not necessarily make society safer.\(^2\)

According to testimony presented to the Senate Budget and Fiscal Review Committee last January by former California Assembly Member Chuck DeVore, who is now the Vice President of the Texas Public Policy Foundation and oversees the Right on Crime Initiative, Texas, despite its long-standing reputation as a “law and order” state, started implementing criminal justice reforms in 2007. Those reforms primarily focus on diverting low-level, non-violent offenders away from prison toward treatment or other supportive, rehabilitative, services. Since this shift away from incarceration toward other alternatives, such as substance abuse and mental health treatment, Texas has seen its crime rate drop faster than the national average. In addition, as of 2013, Texas had closed three of its prisons and has saved more than $2 billion by avoiding the need to build 17,000 additional prison beds.\(^3\)

**California’s Prison Population Declines.** California has moved away from prison toward treatment and rehabilitation within the last five years through Public Safety Realignment in 2011; changes in the Three Strikes law in 2012; and the recent passage of Proposition 47, which reduced several crimes from felony convictions resulting in jail or prison terms to misdemeanors. Thanks in large part to these recent efforts, California’s prison population, which peaked at 173,000 in 2007, has declined to slightly over 114,000 adult inmates as of January 14, 2015. As these sentencing changes continue to be implemented, the population should continue to decline.

**Public Safety Realignment.** In 2011, the Legislature approved a broad realignment of public safety, health, and human services programs from state to local responsibility. Included in this realignment were sentencing law changes requiring that certain lower-level felons be managed by counties in jails and under community supervision rather than sent to state prison. Generally, only felony offenders who have a current or prior offense for a violent, serious, or sex offense are sentenced to serve time in a state prison. Conversely, under realignment, lower-level felons convicted of non-violent, non-serious, and non-sex-related crimes (colloquially referred to as “non-non-nons”) serve time in local jails. In addition, of those felons released from state prison, generally only those with a current violent or serious offense are supervised in the community by state parole agents, with other offenders supervised by county probation departments. Responsibility for housing state parole violators was also shifted from state prisons to county jails.

In adopting this realignment, the Legislature had multiple goals, including reducing the prison population to meet the federal court-ordered cap, reducing state correctional costs, and reserving state prison for the most violent and serious offenders. Another goal of realignment was to improve public safety outcomes by keeping lower-level offenders in local communities where


\(^3\) Testimony of Chuck DeVore before the Senate Budget and Fiscal Review Committee on January 30, 2014.
treatment services exist and where local criminal justice agencies can coordinate efforts to ensure that offenders get the appropriate combination of incarceration, community supervision, and treatment. For many, realignment was based on the confidence that coordinated local efforts are better suited for assembling resources and implementing effective strategies for managing these offenders and reducing recidivism. This was rooted partly in California's successful realignment reform of its juvenile justice over the last 15 years and the success of SB 678 (Leno), Chapter 608, Statutes of 2009, which incentivized evidence-based practices for felony probationers through a formula that split state prison savings resulting from improved outcomes among this offender population.

**Passage of Proposition 36.** The passage of Proposition 36 in 2012 resulted in reduced prison sentences served under the Three Strikes law for certain third strikers whose current offenses were non-serious, non-violent felonies. The measure also allowed resentencing of certain third strikers who were serving life sentences for specified non-serious, non-violent felonies. The measure, however, provides for some exceptions to these shorter sentences. Specifically, the measure required that if the offender has committed certain new or prior offenses, including some drug-, sex-, and gun-related felonies, he or she would still be subject to a life sentence under the three strikes law.4

According to the Governor’s budget, it is estimated that approximately 2,800 inmates will be eligible for resentencing under Proposition 36. The most recent Three-Judge Panel status report on the reduction of the prison population shows that as of January 8, 2015, 1,975 of those eligible have been resentenced and released from prison.

**Passage of Proposition 47.** In November 2014, the voters approved Proposition 47, which requires misdemeanor rather than felony sentencing for certain property and drug crimes and permits inmates previously sentenced for these reclassified crimes to petition for resentencing. The most recent Three-Judge Panel status report on the reduction of the prison population shows that, as of January 14, 2015, 1,436 people had been resentenced and released from prison due to the changes brought by Proposition 47. The Governor’s budget estimates that the 2015-16 average daily state prison population will be reduced by approximately 1,900 inmates as a result of resentencing and avoided new admissions. The chart on the following page provides detailed information on which crimes became misdemeanors following passage of the proposition.

Proposition 47 requires that state savings resulting from the proposition be transferred into a new fund, the Safe Neighborhoods and Schools Fund. The new fund will be used to reduce truancy and support drop-out prevention programs in K-12 schools (25 percent of fund revenue), increase funding for trauma recovery centers (10 percent of fund revenue), and support mental health and substance use disorder treatment services and diversion programs for people in the criminal justice system (65 percent of fund revenue). The Director of Finance is required, on or before July 31, 2016, and on or before July 31 of each fiscal year thereafter, to calculate the state savings for the previous fiscal year compared to 2013-14. Actual data or best estimates are to be used and the calculation is final and must be certified by the State Controller’s Office no later than August 1 of each fiscal year. The first transfer of state savings to the Safe Neighborhoods

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and Schools Fund will occur in 2016-17 after the Department of Finance (DOF) calculates savings pursuant to the proposition. Consequently, the budget does not reflect estimated 2015-16 savings related to Proposition 47.\(^5\)

### Reduction in Existing Penalties Under Proposition 47

<table>
<thead>
<tr>
<th>Crime</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Drug Possession</strong></td>
<td>Prior to the passage of Proposition 47, possession for personal use of most illegal drugs (such as cocaine or heroin) was a misdemeanor, a wobbler,(^6) or a felony-depending on the amount and type of drug. Under current law, such crimes are now misdemeanors. The measure would not change the penalty for possession of marijuana, which was already either an infraction or a misdemeanor.</td>
</tr>
<tr>
<td><strong>Grand Theft</strong></td>
<td>Prior to the passage of Proposition 47, theft of property worth $950 or less was often charged as petty theft, which is a misdemeanor or an infraction. However, such crimes could sometimes be charged as grand theft, which is generally a wobbler. For example, a wobbler charge can occur if the crime involves the theft of certain property (such as cars) or if the offender has previously committed certain theft-related crimes. Proposition 47 limited when theft of property of $950 or less could be charged as grand theft. Specifically, such crimes can no longer be charged as grand theft solely because of the type of property involved or because the defendant had previously committed certain theft-related crimes.</td>
</tr>
<tr>
<td><strong>Shoplifting</strong></td>
<td>Prior to the passage of Proposition 47, shoplifting property worth $950 or less (a type of petty theft) was often a misdemeanor. However, such crimes could also be charged as burglary, which is a wobbler. Under the new law, shoplifting property worth $950 or less will always be a misdemeanor and cannot be charged as burglary.</td>
</tr>
<tr>
<td><strong>Receiving Stolen Property</strong></td>
<td>Prior to the passage of Proposition 47, individuals found with stolen property could be charged with receiving stolen property, which was a wobbler crime. Under current law, receiving stolen property worth $950 or less would always be a misdemeanor.</td>
</tr>
<tr>
<td><strong>Writing Bad Checks</strong></td>
<td>Prior to the passage of Proposition 47, writing a bad check was generally a misdemeanor. However, if the check was worth more than $450, or if the offender had previously committed a crime related to forgery, it was a wobbler crime. Under the new law, it is a misdemeanor to write a bad check unless the check is worth more than $950 or the offender had previously committed three forgery-related crimes, in which case they would remain wobbler crimes.</td>
</tr>
<tr>
<td><strong>Check Forgery</strong></td>
<td>Prior to the passage of Proposition 47, it was a wobbler crime to forge a check of any amount. Under the new law, forging a check worth $950 or less is always a misdemeanor, except that it remains a wobbler crime if the offender commits identity theft in connection with forging a check.</td>
</tr>
</tbody>
</table>


### Crime and Arrest Rates

According to the California Attorney General’s most recent report, every violent and property offense has decreased in both overall number and rate per population. From 2012 to 2013, the violent crime rate decreased 6.5 percent, reaching its lowest level since 1967. In addition, the homicide rate dropped eight percent in 2013. All violent crime categories have experienced double-digit decreases in number and rate from 2008 to 2013.\(^7\)

\(^5\) 2015-16 Governor’s Budget Summary  
\(^6\) “A wobbler” refers to a crime that can either be charged as a misdemeanor or a felony.  
\(^7\) California Department of Justice 2014
In 2013, the arrest rate in California overall was 3.3 percent lower than the arrest rate in 2012. The majority of the decline was due to an 18.8 percent decline in juvenile arrests. The overall violent and property offense arrest rates decreased by 4.4 percent and 3.6 percent, respectively. From 2008 to 2013, the violent and property offense arrest rates have decreased 22.3 percent and 24.7 percent, respectively. Finally, in 2013, 43.8 percent of misdemeanor arrests were either alcohol- or drug-related.

**BACKGROUND**

As of January 21, 2015, there were about 183,000 convicted felons under the jurisdiction of the CDCR; approximately 133,000 were in custody. The Governor’s budget requests over $10 billion, 10 percent of the state’s total General Fund, for the state’s prison system in 2015-16. Projected CDCR caseloads, in the Governor’s budget, including inmates and those released on parole, do not include the impact of Proposition 47. It is expected that those caseloads will be updated during the May Revise to reflect the reduction in both caseloads.

The Governor’s budget proposes $26.9 million (General Fund) for the trial courts for the workload associated with the implementation of Proposition 47. The Governor’s proposed budget assumes that in 2014-15, $934 million will be available in the Community Corrections Subaccount under Public Safety Realignment. Growth funding for that account is estimated to be $128 million on top of the $934 million. For 2015-16, the amounts are estimated to be approximately $1 billion with $114 million, in growth.

**ISSUES TO CONSIDER**

**Reframe the conversation.** The passage of Proposition 47 requires shifting the state’s treatment of people using illegal drugs away from a criminal justice approach toward a public health/treatment approach. Similar to countries like Portugal, who have decriminalized illegal drug use, California now has the opportunity to focus on providing treatment, rather than punishment, for Californians using illegal drugs.

**Proposition 47 State Savings.** Under Proposition 47, the DOF is tasked with calculating the state savings associated with the sentencing changes. The Legislature was not given a role in overseeing how that calculation is determined. However, the Legislature may want to consider working closely with the Administration to ensure that all of the state savings are captured, including savings for prisons, state parole, and, if appropriate, from the Community Corrections Performance Incentives funding.

**Distribution of Proposition 47 Savings.** Proposition 47 does provide some discretion to the Legislature to determine how the savings are distributed. The law requires that 65 percent of the savings be given to the Board of State and Community Corrections to administer a grant program to public agencies aimed at supporting mental health treatment, substance abuse treatment, and

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Calif. Dept. of Justice 2014
diversion programs for the criminal justice system. The grants must emphasize programs that reduce recidivism of people convicted of less serious crimes. Beyond this general direction, there are no parameters set for how the grant program should be structured. Among other options, the Legislature could consider awarding grants to counties that have already begun using innovative programs to improve outcomes and reduce recidivism. The Legislature could also consider requiring that grants be limited to counties that have instituted risk-assessments for their pre-trial populations or any other efforts that they deem are critical to improving the outcomes envisioned by public safety realignment. The savings will not be distributed until the 2016-17 budget. Therefore, the Legislature has time to determine exactly how the grant program should be structured.

**Most Savings Realized at the County Level.** Early estimates suggest that the savings at the state level will likely be between $200 and $300 million. However, it is important for the Legislature to remember that the bulk of the savings will be realized at the local level because, under realignment, most of the people charged with felonies that are now misdemeanors have been housed in county jails. Therefore, this savings should greatly relieve the pressure on counties who have been concerned about the funding level under realignment. Realignment funding is a constitutionally protected revenue stream and does not go down when the number of people serving time for non-violent felonies is reduced. Ideally, counties will reinvest a portion of their savings in increasing access to community-based substance abuse treatment.

**Focus on Providing Quality Treatment and Rehabilitation for People Remaining in State Prison.** With the movement of low-level, non-violent offenders out of state prison and into county jails, the state is now faced with providing adequate treatment, support, and services for those serious and violent inmates who remain. No longer will there be a large population of non-violent offenders who work in fire camps, fill in-prison jobs, or attend training and education. The Legislature should consider working closely with CDCR to ensure that programming is changed appropriately to address the complex needs of all of the people who remain in prison. Rehabilitation efforts can no longer focus primarily on those individuals who are easy to rehabilitate. As with the innovative grant program the Legislature created in last year’s budget, the Legislature may wish to either expand or redirect programming funds to provide on-going support for organizations currently working in state prisons that provide treatment and programs focusing on restorative justice and offender responsibility. The vast majority of people who are currently serving time in prison will eventually be released. It will benefit the state to provide the treatment and programs necessary to ensure a successful return to society for people leaving prison.

**Consider Further Reforms.** The Legislature may wish to take advantage of the current trends in sentencing to look further into sentencing enhancements and mandatory minimum sentences to see if there are other reforms that would be appropriate. For example, county sheriffs’ have been concerned the last several years about realigned felons serving long sentences in county jails and the fact that they are not equipped to properly house and provide programming for people serving long terms. Given that the realigned population is made up of people who have been convicted of non-serious, non-violent, and non-sex-related crimes, the Legislature may wish to look at remaining sentencing laws that result in those types of people receiving sentences that extend ten, twenty, or thirty years. There may continue to be areas of the penal code where the sentences continue outweigh the severity of the crimes committed.
Dependency Counsel Caseloads

BACKGROUND

The Judicial branch is responsible for the interpretation of law, the protection of an individual’s rights, the orderly settlement of all legal disputes, and the adjudication of accusations of legal violations. The branch consists of statewide courts (the Supreme Court and Courts of Appeal), trial courts in each of the state’s 58 counties, and statewide entities of the branch (the Judicial Council, Judicial Branch Facility Program, and the Habeas Corpus Resource Center). The branch receives revenue from several funding sources including the state General Fund, civil filing fees, criminal penalties and fines, county maintenance-of-effort payments, and federal grants.

Overall Trial Court Funding. Due to the state’s fiscal situation, the Judicial branch, like most areas of state and local government, received a series of General Fund reductions from 2008-09 through 2012-13. Many of these General Fund reductions were offset by increased funding from alternative sources, such as special fund transfers and fee increases. A number of these offsets were one-time solutions (such as the use of trial court reserves) and for the most part, those options have been exhausted. In addition, trial courts partially accommodated their ongoing reductions by implementing operational actions, such as leaving vacancies open, closing courtrooms and courthouses, and reducing clerk office hours. Some of these operational actions resulted in reduced access to court services, longer wait times, and increased backlogs in court workload.

2014 Budget Act. The 2014 Budget Act included approximately $2.5 billion for local trial courts. The Legislature approved an increase of $60 million General Fund for trial court funding, which combined with other funding increases included in the budget, resulted in a total increase of $160 million General Fund for the trial courts. Specifically, the budget provided a five percent increase in state trial court operations, for a total increase of $86.3 million; the Legislature authorized an increase of $42.8 million General Fund to reflect increased health benefit and retirement adjustment costs for trial court employees; and the Legislature authorized a General Fund increase of $30.9 million General Fund to account for an estimated shortfall in the Trial Court Revenue Trust Fund.

Dependency Court and the Child Welfare System. Every year, approximately 500,000 children and their parents come into contact with the child welfare system due to allegations of abuse and neglect. Of those complaints filed on behalf of children, approximately 84,000 are found to be substantiated and, roughly, 32,000 enter the foster care system. For children and families involved in the child welfare system, almost every significant decision is overseen by a judge, including the child’s placement, involvement of family members, education, and health and mental health services. Every interested party in dependency court is represented by their own lawyer. The county child welfare department has its counsel, the parents have either one or two attorneys, depending on whether they are being represented together or separately, and children are represented by their own counsel.
The Role of Dependency Counsel. Given the impact of the decisions being made by the court on the child’s behalf, the child’s attorney plays a key role. The attorney has the primary responsibility of advocating for that child’s protection, safety, and physical and emotional well-being. Serving dually as Guardian Ad Litem (pursuant to the Child Abuse Prevention and Treatment Act) and attorney, the duties of a child’s attorney often go beyond the courtroom. The attorney ascertains and advocates for the needs of the minor both inside the courtroom and outside of the legal proceedings.

The attorney is tasked with advocating in court for needed resources and/or working outside of court to access appropriate placements and intervention services. Similarly, when youth in the child welfare system have unmet special education needs, are denied essential benefits or become involved with the juvenile justice system, their dependency attorneys are available to provide the court or necessary agency with any historical information or other relevant information.

A 2008 study from Chapin Hall Center for Children found that children with effective counsel were moved to permanency at about twice the rate of unrepresented children. A 2010 study found better court outcomes for Los Angeles County “crossover youth” (those who are dually involved in the Dependency and Delinquency Courts) when the youth had the involvement of their own attorneys.

As part of advocating for their client, a dependency lawyer is required to do certain things under state law. The attorney must:

- Advocate generally for the protection, safety, and physical and emotional well-being of the child.
- Advocate for the child’s interests.
- Investigate to ascertain the facts, including the interviewing of witnesses such as parents, relatives, foster parents, teachers, school administrators.
- Make recommendations to the court concerning the child’s welfare.
- Interview children older than four years old in such a way so as to be able to determine the child’s wishes.
- Assess the child’s well-being.
- Advise the court of the child’s wishes.
- Not advocate for the return of the child to his or her parents if, to the best of his or her knowledge, return of the child conflicts with the protection and safety of the child.
- Investigate the interests of the child beyond the scope of the juvenile proceeding, and report to the court other interests of the child that may need to be protected by the institution of other administrative or judicial proceedings.

According to children’s attorneys, these specific tasks are mandated against the backdrop of a lawyer’s general ethical duty to represent a client zealously and diligently. If a lawyer does not do the things required of him or her by law, or if a lawyer more generally fails to represent a client zealously or diligently, the lawyer is subject to discipline, including disbarment.
“Dependency Counsel Caseload Standards” Report. SB 2160 (Schiff), Chapter 450, Statutes of 2000 required that: (1) counsel be appointed for children in almost all dependency cases; (2) appointed counsel have caseloads and training that ensure adequate representation; and, (3) the Judicial Council promulgate rules establishing caseload standards, training requirements, and guidelines for appointment of counsel for children. In 2001, the Judicial Council adopted a rule that mandated the appointment of counsel for children subject to dependency proceedings in all but the rarest of circumstances, and the council directed staff to undertake a study to identify caseload standards for attorneys representing both parents and children. The findings of that study were released to the Legislature in April 2008.¹ The study recommended that a maximum caseload of 141 clients per full-time dependency attorney be the base-level standard of performance and a maximum of 77 clients was identified as necessary for an optimal standard of performance. To date, the Judicial Council has not adopted a rule of court establishing caseload standards.

Other Caseload Standards. According to the National Association of Counsel for Children, a full-time child’s attorney should represent no more than 100 clients at one time. This is the same standard recommended by the U.S. Department of Health and Human Services, as well as the American Bar Association. In 2008, the Dependency Counsel Caseload Standards report discussed above concluded that the basic caseload standard, where the attorney is supported by a social work investigator, is a maximum of 188 child clients, while the optimal standard is 77. In 2006, a federal court in Atlanta ruled that high caseloads violated children’s constitutional right to zealous and effective legal representation. In response, the average caseloads for children’s attorneys in Atlanta were reduced from 500 to 90. Several states, including Massachusetts, New York, Arkansas and Wyoming also have strict caseload standards.

Dependency Counsel Caseloads and Budget. The Judicial Council currently allocates $103.7 million annually for dependency council. With court-appointed counsel providing representation to approximately 142,500 parents and children, the current level of funding is sufficient to provide representation at a rate of one attorney for approximately 250 clients. The Judicial Council does not collect the data necessary to determine the dependency counsel caseloads by county. However, they have provided an estimate, based on the number of child clients and the funding allocations. Below is a breakdown of the estimated caseloads for the largest counties in the state.

Estimated 2014-15 Attorney:Child/Parent Caseloads

<table>
<thead>
<tr>
<th>County</th>
<th>Attorney:Client Caseload</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alameda</td>
<td>156</td>
</tr>
<tr>
<td>Contra Costa</td>
<td>164</td>
</tr>
<tr>
<td>Fresno</td>
<td>187</td>
</tr>
<tr>
<td>Kern</td>
<td>289</td>
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<tr>
<td>Los Angeles</td>
<td>328</td>
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<tr>
<td>Orange</td>
<td>173</td>
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<tr>
<td>Riverside</td>
<td>461</td>
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<tr>
<td>Sacramento</td>
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<tr>
<td>San Bernardino</td>
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<tr>
<td>San Diego</td>
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<tr>
<td>San Francisco</td>
<td>142</td>
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<tr>
<td>San Joaquin</td>
<td>155</td>
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<tr>
<td>Santa Clara</td>
<td>134</td>
</tr>
<tr>
<td>Tulare</td>
<td>456</td>
</tr>
<tr>
<td>Ventura</td>
<td>500</td>
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<tr>
<td><strong>Statewide Average</strong></td>
<td><strong>248</strong></td>
</tr>
<tr>
<td><strong>Minimum Standard</strong></td>
<td><strong>188</strong></td>
</tr>
</tbody>
</table>

Source: Judicial Council

GOVERNOR’S PROPOSAL

**Total Judicial Branch Funding.** Requests total funding of $3.5 billion ($1.6 billion General Fund) for the Judicial Branch, of which $2.7 billion is provided in support of trial court operations.

**Local Trial Court Funding.** Requests $90 million (General Fund) in on-going, additional funding to support trial court operations.

**Dependency Counsel Funding.** The Administration commits to working with the Judicial Council to develop a caseload-based allocation methodology and explore ways to reduce the current caseloads for dependency counsel.

**Employee Benefit Costs.** Requests $42.7 million (General Fund) for increases in trial court employee benefit costs.
**Trial Court Trust Fund Backfill.** Requests $19.8 million (General Fund) to backfill reductions in fine and penalty revenue in 2015-16.

** ISSUES TO CONSIDER  

**Should funding for dependency counsel assigned to children be augmented?** Given the role that children’s attorneys play in determining their futures while they are in the child welfare system, the Legislature may want to consider whether or not the existing funding for dependency counsel is sufficient.

**Should the trial court allocation formula be revised?** The estimated caseloads provided by the Judicial Council show a substantial difference in funding levels and caseload ratios across counties. Even among the largest counties, the ratio varies from 500-to-1 in Ventura County to 134-to-1 in Santa Clara County. While the Governor has committed to working with the Judicial Council to develop a caseload driven allocation methodology, the Legislature may want to consider directing staff and LAO to work with the Administration and Judicial Council on that effort. Alternatively, the Legislature may want to consider requiring the Administration and the Judicial Council to report on their progress during budget subcommittee hearings this spring.

**Should there be statutorily required caseload caps for children’s attorneys?** As noted above, SB 2160 (Schiff), Chapter 450, Statutes of 2000, required the adoption of a rule of court establishing appropriate caseload standards. That rule has not been adopted in the last 15 years. Given the failure of the Judiciary to act on that statutory requirement, the Legislature may want to consider placing the appropriate caseload standards in statute.
Unemployment Insurance

BACKGROUND

The Unemployment Insurance (UI) program is a federal-state program, authorized in federal law but with broad discretion for states to set benefit and employer contribution levels. The UI program provides weekly payments to eligible workers who lose their jobs through no fault of their own. Benefits range from $40 to $450 per week for up to 26 weeks, depending on earnings in a 12-month base period. The program is financed by unemployment tax contributions paid by employers, based on the number of employees, on the first $7,000 of taxable wages paid to each employee. The contribution schedule is comprised of seven schedules, with a range of 0.1 percent (the lowest rate on Schedule AA) to 6.2 percent (the maximum rate on Schedule F). Current law also includes a provision to add a 15 percent emergency solvency surcharge when the UI fund reserve is low (Schedule F+). California employers have been on this emergency F+ schedule since calendar year 2004.

The UI Trust Fund (UI fund) became insolvent in January 2009 and ended that year with a shortfall of $6.2 billion. The contributing factors to the insolvency of the UI fund are: (1) significant statutory increases to the UI benefit level that began in 2002—these legislative changes increased the maximum weekly benefit amount from $230 per week to $450 per week; (2) no change in the UI financing structure despite significant increases to UI benefits—for example, the taxable wage ceiling has remained at the federal minimum level of $7,000 since 1983; (3) the inability of the fund to build a healthy reserve in the last decade—the Employment Development Department (EDD) indicates that the existing UI financing system can be sustained in the long run only if the state unemployment rate averaged around four percent over time; and (4) the current economy which resulted in increased UI benefit payments and decreased revenues.

With the UI fund insolvent, the state began borrowing funds from the Federal Unemployment Account in order to continue paying UI benefits to qualifying claimants without interruption. The UI fund deficit was $10.2 billion at the end of 2013 and has decreased to $8.7 billion at the end of 2014. Generally, loans lasting more than one year require interest payments; the federal American Recovery and Reinvestment Act (ARRA) of 2009, provided temporary relief to states from making interest payments on UI loans through December 31, 2010. With the expiration of the ARRA provisions: interest of $303.5 million was paid in September 2011; interest of $308.2 million was paid in September 2012; the 2013 interest payment was $291.1 million; and, the most recent payment of $217 million was provided in September 2014. Interest will continue to accrue and be payable annually until the principal on the federal UI loan is repaid. Federal law requires that the interest payment come from state funds. Due to the condition of the General Fund, both the 2011 and 2012 interest payments were made by borrowing funds from the Unemployment Compensation Disability Fund.
California’s outstanding loan to the federal government is estimated to be $8.7 billion at the end of 2014. The General Fund annual interest payments are expected to gradually decline each year—from $217 million in 2014-15 to $73 million in 2018-19. Federal law also includes provisions to ensure that a state does not continue to incur loans over an extended period. Specifically, if a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid before November of the second year or employers face higher federal UI taxes.

The full federal unemployment insurance tax rate is six percent. Employers receive a 5.4 percent credit (Federal Unemployment Tax Act [FUTA] Credit Reduction), resulting in an effective tax rate of 0.6 percent on the first $7,000 of earnings per employee on an annual basis, or $42 per employee. Due to California carrying an outstanding loan balance for two consecutive years, the FUTA credit reduction began decreasing in calendar year 2011, resulting in increased employer costs in calendar year 2012. Each year that the loans remain outstanding, the FUTA credits will continue to decrease by 0.3 percent, resulting in dramatically increasing costs for employers, as displayed in table below. These additional federal taxes pay down the principal on the federal loan.

**Federal Unemployment Tax Act Credit Reduction**

<table>
<thead>
<tr>
<th></th>
<th>2012*</th>
<th>2013*</th>
<th>2014*</th>
<th>2015*</th>
</tr>
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<tbody>
<tr>
<td>Tax Rate</td>
<td>1.2%</td>
<td>1.5%</td>
<td>1.8%</td>
<td>2.1%</td>
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<tr>
<td>Estimated Additional Tax Collections Resulting from the FUTA Credit Reduction per Employee</td>
<td>$24.00</td>
<td>$48.00</td>
<td>$72.00</td>
<td>$100.00</td>
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<tr>
<td>Estimated Additional Tax Collections Resulting from FUTA Credit Reduction</td>
<td>$290 million</td>
<td>$582 million</td>
<td>$894 million</td>
<td>$1.2 billion</td>
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</table>

*Calendar Year.

The Governor proposes to utilize $184.4 million General Fund to pay the annual interest payment due to the federal government for the quarterly loans the EDD has been obtaining from the federal government since January 2009 to cover the UI Fund deficit and make payment to UI claimants without interruption.

**ISSUES TO CONSIDER**

**Underlying Financial Structure of the UI Trust Fund.** One of the contributing factors to the current UI fund insolvency is the inability of the fund to build a healthy reserve in the last decade. In prior decades, the fund balance built sufficient reserves during times of economic expansion so that the lowest tax rate schedule (as described above) could be used before entering a period of economic contraction. This pattern ended in the 1990s. In the years leading up to the recession of the early 2000s, the UI fund was unable to build a high enough reserve to safely
cover the next recession. Employers were still on schedule C in the late 1990s and in the early 2000s, as the state entered into a brief recession. Soon after, benefits levels were increased with no changes to the revenue structure. As the state entered this most recent recession in 2008, in which the unemployment rate hit record highs, the fund had an insufficient reserve, even though employers had been on the highest state tax rate schedule F+ since 2004. The EDD estimates that even as more firms pay higher rates under the F+ schedule, the current system can only generate about $6 billion in annual revenues. The situation in the late 1990s and early 2000s suggests that the UI financing system was not robust enough to build sufficient reserves. According to EDD estimates, the existing UI financing system can be sustained in the long run only if the state unemployment rate averaged around 4 percent over time. Such low rates of unemployment have been historically rare in California.

Potential Solutions to UI Trust Fund Insolvency. As the Legislative Analyst’s Office (LAO) noted in its October 2010 report entitled, *California’s Other Budget Deficit: The Unemployment Insurance Fund Insolvency*, the Legislature essentially has three main choices for returning the UI fund to solvency—reducing benefit payments, increasing employer tax contributions, or adopting some combination of the two. To assist the Legislature, the LAO examined multiple scenarios for achieving solvency and found that: (1) decreasing UI benefits alone cannot address the fund insolvency in the near future; (2) options involving UI tax increases could quickly improve the fund condition; (3) employer tax increases could hurt California’s competitiveness; and, (4) the UI financing structure is not sufficiently robust. The LAO recommended a balanced approach of tax increases, benefit reductions, and eligibility changes to address the long-term financial health of the UI program. These policy options remain viable, and could be phased-in over several years if the goal were to minimize the potential adverse economic effects of such proposals on UI beneficiaries and employers.
APPENDIX

Timeline for the 2015-16 Senate Budget Bill ................................................................. i
Assignments of the Senate Budget Committee Staff .................................................... ii
California State Budget History .................................................................................... iii
Fiscal Schedules:
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- General Fund Revenues ................................................................................................. v
- General Fund Proposition 98 Expenditures ................................................................. vi
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## Timeline for the 2015-16 Budget Bill

<table>
<thead>
<tr>
<th>Day</th>
<th>Month</th>
<th>Event</th>
</tr>
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<tbody>
<tr>
<td>Friday</td>
<td>January 9</td>
<td>Governor submits State Budget to the Legislature.</td>
</tr>
<tr>
<td>Friday</td>
<td>January 9</td>
<td>Committee releases <em>Quick Summary of Governor's Proposed Budget.</em></td>
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<tr>
<td>Monday</td>
<td>January 13</td>
<td>Legislative Analyst submits <em>Overview of the Governor's Budget.</em></td>
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<tr>
<td>Thursday</td>
<td>January 22</td>
<td>Committee conducts overview hearing of the budget. Department of Finance presents budget and the Legislative Analyst provides initial review.</td>
</tr>
<tr>
<td>Monday</td>
<td>February 9</td>
<td>Committee releases <em>Overview of the 2015-16 Governor's Budget.</em></td>
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<tr>
<td>Thursday</td>
<td>February 12</td>
<td>Full Budget Committee holds oversight hearing Local and State Water Funding Relationships.</td>
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<tr>
<td>Thursday</td>
<td>February 26</td>
<td>Full Budget Committee holds oversight hearing on Workforce Investment.</td>
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<tr>
<td>Wednesday</td>
<td>March 4</td>
<td>Full Budget Committee holds oversight hearing on Funding for Early Childhood Education.</td>
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<td>Thursday</td>
<td>March 5</td>
<td>Subcommittee hearings may begin.</td>
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<tr>
<td>Wednesday</td>
<td>April 1</td>
<td>Department of Finance submits Finance Letters.</td>
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<tr>
<td>Thursday</td>
<td>March 26</td>
<td>Spring Recess begins.</td>
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<td>Monday</td>
<td>April 6</td>
<td>Legislature reconvenes from Spring Recess.</td>
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<td>Friday</td>
<td>May 1</td>
<td>Department of Finance submits final capital outlay revisions.</td>
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<td>Thursday</td>
<td>May 14</td>
<td>Governor delivers May Revision to the Legislature.</td>
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<tr>
<td>Monday</td>
<td>June 15</td>
<td>Legislature must pass budget to meet constitutional deadline for passage of the budget.</td>
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## Staff Assignments

<table>
<thead>
<tr>
<th>Category</th>
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<tbody>
<tr>
<td><strong>Budget Condition</strong></td>
<td>Mark Ibele, Farra Bracht</td>
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<td><strong>Corrections/Public Safety</strong></td>
<td>Julie Salley-Gray</td>
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<td><strong>Education</strong></td>
<td>Elisa Wynne, Anita Lee, Samantha Lui</td>
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<td><strong>K-12</strong></td>
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<td><strong>Environmental Protection</strong></td>
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<td><strong>Labor &amp; Employee Compensation</strong></td>
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<td><strong>Local Government</strong></td>
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<td><strong>Health</strong></td>
<td>Michelle Baass</td>
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<td><strong>Human Services</strong></td>
<td>Samantha Lui, Peggy Collins</td>
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<td><strong>Revenues</strong></td>
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<td><strong>State Administration</strong></td>
<td>Brady Van Engelen, Farra Bracht, Mark Ibele</td>
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<td><strong>Transportation</strong></td>
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<td><strong>Veterans Affairs</strong></td>
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<td><strong>Committee Secretary</strong></td>
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<td><strong>Committee Assistant</strong></td>
<td>Mary Teabo</td>
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# California State Budget History

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<td>SB 77/38</td>
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<td>AB 1801/47</td>
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| 2014-15c    | SB 852/Ch. 25        | 6/15 6/20                   | 156.4                     

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*a 1966 Second Extraordinary Session.

*b First year budget was to be enacted by June 15.

*c June 15 constitutional deadline met (8).
### General Fund Multi-Year Forecast at 2015-16 Governor's Budget

(Dollars in Millions)

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<td><strong>RESOURCES:</strong></td>
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<td>$1,505</td>
<td>$1,569</td>
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<td>Revenues/Transfers</td>
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<td>$114,600</td>
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<td>-$1,220</td>
<td>-$1,080</td>
<td>-$1,134</td>
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<td><strong>Total Resources</strong></td>
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<td>Non-Proposition 98</td>
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<td>Special Fund for Economic Uncertainties</td>
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<td>$534</td>
<td>$598</td>
<td>$1,141</td>
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<td>Budget Stabilization Account/Rainy Day Fund</td>
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<td>$82</td>
<td>$64</td>
<td>$543</td>
<td>-$1,136</td>
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## General Fund Revenues at 2015-16 Governor’s Budget

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<td>373</td>
<td>380</td>
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<td>4 Cigarette Tax</td>
<td>84</td>
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<td>2,690</td>
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<td>1</td>
<td>1</td>
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<td>8 Retail Sales and Use Taxes</td>
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<td><strong>10 Minor Revenues/Transfers</strong></td>
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<tr>
<td>11 Misc Revenue from Local Agencies</td>
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<td>12 Income from Pooled Money Investments</td>
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<td>46</td>
<td>113</td>
<td>215</td>
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<td>13 State Lands Royalties</td>
<td>342</td>
<td>286</td>
<td>286</td>
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<td>14 Abandoned Property</td>
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<td>452</td>
<td>445</td>
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<td>15 Miscellaneous Revenue</td>
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<td>16 Tribal Gaming Revenues</td>
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<tr>
<td>17 Penalty Assessments - Other</td>
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<td>53</td>
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</tr>
<tr>
<td>18 Loan Repayments to Other Funds</td>
<td>-851</td>
<td>-965</td>
<td>-1,123</td>
<td>-694</td>
<td>-246</td>
</tr>
<tr>
<td>19 All Other Transfers and Loans</td>
<td>849</td>
<td>433</td>
<td>184</td>
<td>-100</td>
<td>-128</td>
</tr>
<tr>
<td>20 Transfer to BSA for Rainy Day Funds</td>
<td>-1,606</td>
<td>-1,220</td>
<td>-1,080</td>
<td>-1,134</td>
<td>-1,045</td>
</tr>
<tr>
<td>21 Remaining Others</td>
<td>251</td>
<td>223</td>
<td>224</td>
<td>226</td>
<td>228</td>
</tr>
<tr>
<td><strong>22 Total Minor Revenues/Transfers</strong></td>
<td>$345</td>
<td>-$159</td>
<td>-$457</td>
<td>-$274</td>
<td>$219</td>
</tr>
<tr>
<td><strong>23 Total Revenues</strong></td>
<td>$108,042</td>
<td>$113,380</td>
<td>$117,693</td>
<td>$123,147</td>
<td>$124,846</td>
</tr>
</tbody>
</table>

January 9, 2015
### General Fund Prop 98 Expenditures at the 2015-16 Governor’s Budget

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposition 98 guarantee (GF)</td>
<td>38,740</td>
<td>38,370</td>
<td>40,365</td>
<td>42,794</td>
<td>44,778</td>
</tr>
<tr>
<td>Education Protection Account</td>
<td>7,908</td>
<td>8,649</td>
<td>7,845</td>
<td>7,041</td>
<td>4,795</td>
</tr>
<tr>
<td>Local Property Tax</td>
<td>16,505</td>
<td>18,697</td>
<td>20,216</td>
<td>21,573</td>
<td>22,698</td>
</tr>
<tr>
<td><strong>Total Prop 98 guarantee</strong></td>
<td>63,153</td>
<td>65,716</td>
<td>68,426</td>
<td>71,408</td>
<td>72,271</td>
</tr>
<tr>
<td>Percent Change</td>
<td>7.64%</td>
<td>4.06%</td>
<td>4.12%</td>
<td>4.36%</td>
<td>1.21%</td>
</tr>
<tr>
<td>Prop 98 Test</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>General Fund Base</td>
<td>38,740</td>
<td>38,370</td>
<td>40,365</td>
<td>42,794</td>
<td>44,778</td>
</tr>
<tr>
<td>Education Protection Account</td>
<td>7,908</td>
<td>8,649</td>
<td>7,845</td>
<td>7,041</td>
<td>4,795</td>
</tr>
<tr>
<td>QEIA Payment 1/</td>
<td>(410)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Williams Settlement 1/</td>
<td>(188)</td>
<td>(273)</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Settle up for old years 1/</td>
<td>0</td>
<td>(256)</td>
<td>0</td>
<td>445</td>
<td>811</td>
</tr>
<tr>
<td>Mandate Payments</td>
<td>(1,425)</td>
<td>(218)</td>
<td>0</td>
<td>(445)</td>
<td>(811)</td>
</tr>
<tr>
<td><strong>Total General Fund</strong></td>
<td>46,648</td>
<td>47,019</td>
<td>48,210</td>
<td>50,280</td>
<td>50,384</td>
</tr>
</tbody>
</table>

### Prop 98 Obligations

| Maintenance Factor Created/Paid (+/-) | -3,805 | -725 | 24 | 0 | 2,247 |
| Outstanding Pre 2014-15 Maintenance Factor 2/ | 2,587 | 1,937 | 2,013 | 2,101 | 2,192 |
| Outstanding Post 2014-15 Maintenance Factor | N/A | 0 | 24 | 25 | 2,273 |
| Settle-Up Balance | 1,512 | 1,256 | 1,256 | 811 | 0 |
| Budgetary Deferrals Balance | 0 | 0 | 0 | 0 | 0 |
| QEIA Balance | 0 | 0 | 0 | 0 | 0 |
| Mandate Balance 3/ | 4,219 | 4,023 | 4,023 | 3,622 | 2,892 |
| Williams Settlement Balance | 273 | 0 | 0 | 0 | 0 |

1/ These amounts are proposed to be appropriated to fund prior-year Prop 98 commitments. Since this amount is attributable to prior year obligations, the actual expenditure is reflected as a Prior Year Adjustment to the beginning General Fund balance once the amount is proposed to be appropriated.

2/ This amount reflects the maintenance factor balance that must be paid prior to making deposits into the Prop 98 reserve.

3/ Mandate balance is reduced by 90 percent of mandate payments because mandate payments will be made on a per ADA/FTES basis that result in some payments made to entities without outstanding mandate claims.
### General Fund Non-98 Multi-Year Expenditures by Agency at 2015-16 Governor's Budget

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>N98 excludes Capital Outlay, Debt Service</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Legislative, Executive</td>
<td>$1,201</td>
<td>$1,111</td>
<td>$1,131</td>
<td>$1,126</td>
<td>$1,124</td>
</tr>
<tr>
<td>Courts</td>
<td>1,687</td>
<td>1,842</td>
<td>1,869</td>
<td>1,908</td>
<td>1,957</td>
</tr>
<tr>
<td>Business, Consumer Services, and Housing</td>
<td>126</td>
<td>27</td>
<td>27</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Transportation</td>
<td>83</td>
<td>84</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>1,507</td>
<td>1,460</td>
<td>1,290</td>
<td>1,279</td>
<td>1,281</td>
</tr>
<tr>
<td>Environmental Protection</td>
<td>74</td>
<td>63</td>
<td>56</td>
<td>55</td>
<td>55</td>
</tr>
<tr>
<td>Health and Human Services</td>
<td>30,333</td>
<td>31,764</td>
<td>34,274</td>
<td>36,142</td>
<td>38,043</td>
</tr>
<tr>
<td>Affordable Care Act County Offset</td>
<td>(-725)</td>
<td>(-698)</td>
<td>(-698)</td>
<td>(-698)</td>
<td>(-698)</td>
</tr>
<tr>
<td>Federal Funds Offset 1/</td>
<td>(-527)</td>
<td>(-147)</td>
<td>(0)</td>
<td>(0)</td>
<td>(0)</td>
</tr>
<tr>
<td>Corrections and Rehabilitation</td>
<td>9,490</td>
<td>9,625</td>
<td>9,708</td>
<td>9,781</td>
<td>9,876</td>
</tr>
<tr>
<td>Receiver's Cost</td>
<td>(1,721)</td>
<td>(1,779)</td>
<td>(1,829)</td>
<td>(1,879)</td>
<td>(1,929)</td>
</tr>
<tr>
<td>AB 109 Savings</td>
<td>(-1,458)</td>
<td>(-1,544)</td>
<td>(-1,544)</td>
<td>(-1,544)</td>
<td>(-1,544)</td>
</tr>
<tr>
<td>Education</td>
<td>10,147</td>
<td>11,216</td>
<td>12,122</td>
<td>12,727</td>
<td>13,284</td>
</tr>
<tr>
<td>STRS Contribution</td>
<td>(1,486)</td>
<td>(1,928)</td>
<td>(2,389)</td>
<td>(2,463)</td>
<td>(2,539)</td>
</tr>
<tr>
<td>Labor and Workforce Development</td>
<td>282</td>
<td>265</td>
<td>188</td>
<td>129</td>
<td>72</td>
</tr>
<tr>
<td>Government Operations</td>
<td>727</td>
<td>701</td>
<td>673</td>
<td>627</td>
<td>626</td>
</tr>
<tr>
<td>General Government</td>
<td>3,991</td>
<td>2,378</td>
<td>2,726</td>
<td>3,013</td>
<td>3,327</td>
</tr>
<tr>
<td>Non-Agency Departments</td>
<td>(1,214)</td>
<td>(618)</td>
<td>(578)</td>
<td>(535)</td>
<td>(520)</td>
</tr>
<tr>
<td>Tax Relief/Local Government</td>
<td>(446)</td>
<td>(444)</td>
<td>(458)</td>
<td>(477)</td>
<td>(501)</td>
</tr>
<tr>
<td>Statewide Expenditures</td>
<td>(725)</td>
<td>(1,316)</td>
<td>(1,690)</td>
<td>(2,001)</td>
<td>(2,306)</td>
</tr>
<tr>
<td>Supplemental Payment to Economic Recovery Bonds</td>
<td>(1,606)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total PERS Contribution (GF) (Excluding CSU)</td>
<td>(2,120)</td>
<td>(2,318)</td>
<td>(2,526)</td>
<td>(2,609)</td>
<td>(2,702)</td>
</tr>
<tr>
<td>Capital Outlay</td>
<td>149</td>
<td>162</td>
<td>95</td>
<td>110</td>
<td>113</td>
</tr>
<tr>
<td>Debt Service</td>
<td>5,274</td>
<td>5,581</td>
<td>5,260</td>
<td>5,402</td>
<td>5,815</td>
</tr>
<tr>
<td><strong>Total N98 Expenditures</strong></td>
<td>$65,071</td>
<td>$66,279</td>
<td>$69,419</td>
<td>$72,324</td>
<td>$75,598</td>
</tr>
</tbody>
</table>

1/ Hospital finance waiver (Bridge to Reform) expires in 2015.
## Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2
### 2015-16 Governor's Budget
(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Budgetary Borrowing</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans from Special Funds</td>
<td>$3,028</td>
<td>$965</td>
<td>$1,123</td>
<td>$694</td>
<td>$246</td>
<td>$0</td>
</tr>
<tr>
<td>Underfunding of Proposition 98—Settle-Up</td>
<td>1,512</td>
<td>256</td>
<td>0</td>
<td>445</td>
<td>811</td>
<td>0</td>
</tr>
<tr>
<td>Unpaid Mandate Claims for Local Governments (prior to 2004-05)</td>
<td>257</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>$257</td>
</tr>
</tbody>
</table>

| **State Retirement Liabilities** |                           |                                            |                                            |                                            |                                            |                                        |
| State Retiree Health            | 71,773                    | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |
| State Employee Pensions          | 49,978                    | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |
| Teacher Pensions                 | 74,374                    | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |
| Judges' Pensions                 | 3,371                     | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |
| Deferred payments to CalPERS     | 530                       | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |

| **University of California Retirement Liabilities** |                           |                                            |                                            |                                            |                                            |                                        |
| University of California Employee Pensions | 7,633                    | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |
| University of California Retiree Health | 14,519                   | 0                                          | 0                                          | 0                                          | 0                                          | N/A                                    |

| **Total**                        | $226,975                  | $1,221                                     | $1,123                                     | $1,139                                     | $1,057                                     | $257                                   |

1/ Amount outstanding reflects $533 million paid under the 2014 Budget Act trigger.

2/ The state portion of the unfunded liability for teacher pensions is $19.932 billion.
## Prop 2 Rainy Day Fund at 2015-16 Governor’s Budget

(Dollars in Millions)

<table>
<thead>
<tr>
<th>Description</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1.5% of General Fund Revenues &amp; Transfers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. General Fund Revenues and Transfers (before BSA transfer)</td>
<td>$114,600</td>
<td>$118,773</td>
<td>$124,281</td>
<td>$125,891</td>
</tr>
<tr>
<td>2. 1.5% of General Fund Revenues &amp; Transfers</td>
<td>$1,719</td>
<td>$1,782</td>
<td>$1,864</td>
<td>$1,888</td>
</tr>
</tbody>
</table>

**Capital Gain Revenues (Sec 20(b))**

<table>
<thead>
<tr>
<th>Description</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. General Fund Tax Proceeds</td>
<td>$114,136</td>
<td>$118,625</td>
<td>$123,860</td>
<td>$125,091</td>
</tr>
<tr>
<td>4. Personal Income Taxes from Capital Gains</td>
<td>$10,577</td>
<td>$10,235</td>
<td>$10,598</td>
<td>$10,403</td>
</tr>
<tr>
<td>5. % of General Fund Tax Proceeds</td>
<td>9.3%</td>
<td>8.6%</td>
<td>8.6%</td>
<td>8.3%</td>
</tr>
<tr>
<td>6. 8% of General Funds Tax Proceeds</td>
<td>$9,131</td>
<td>$9,490</td>
<td>$9,909</td>
<td>$10,007</td>
</tr>
<tr>
<td>7. Personal Income Taxes from Capital Gains in Excess of 8% General Fund Tax Proceeds</td>
<td>$1,446</td>
<td>$745</td>
<td>$689</td>
<td>$396</td>
</tr>
<tr>
<td>8. Prop 98 Share of Capital Gains Tax Revenue above 8%</td>
<td>$725</td>
<td>$367</td>
<td>$285</td>
<td>$194</td>
</tr>
<tr>
<td>9. Non 98 Share of Capital Gains Tax Revenue above 8%</td>
<td>$721</td>
<td>$378</td>
<td>$404</td>
<td>$202</td>
</tr>
<tr>
<td>10. Total Available (Lines 2 and 9)</td>
<td>$2,440</td>
<td>$2,160</td>
<td>$2,268</td>
<td>$2,090</td>
</tr>
<tr>
<td>11. Debt Repayment (50%)</td>
<td>$1,220</td>
<td>$1,080</td>
<td>$1,134</td>
<td>$1,045</td>
</tr>
<tr>
<td>12. Deposit to Rainy Day Fund (50%)</td>
<td>$1,220</td>
<td>$1,080</td>
<td>$1,134</td>
<td>$1,045</td>
</tr>
</tbody>
</table>

**Cumulative Balance in Rainy Day Fund**

| 1/ | $2,826 | $3,906 | $5,040 | $6,085 |

1/ Includes balance of $1,606m from 2014-15.