

# OVERVIEW OF THE 2016-17 BUDGET BILL

SENATE BILL 825  
AS INTRODUCED JANUARY 7, 2016

SENATE COMMITTEE ON BUDGET AND FISCAL REVIEW  
SENATOR MARK LENO, CHAIR

FEBRUARY 2016

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Senate Bill 825

*As Introduced on January 7, 2016*

Senate Committee on Budget and Fiscal Review

Senator Mark Leno, Chair

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Dear Colleague:

I am pleased to provide you with a copy of the *Overview of the 2016-17 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.

The first section presents 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 relevant background material, an explanation of the budget proposal, and a discussion of important matters to consider.

In the Appendix, we include supplementary fiscal documents prepared by the Department of Finance. The Appendix also includes a working timeline for completing the 2016-17 budget, a historical listing of adopted state budgets, and a schedule 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,

A handwritten signature in black ink that reads "Mark Leno".

MARK LENO  
Chair

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# Budget Overview

## INTRODUCTION

The Governor has proposed a budget for 2016-17 which includes resources—carry forward balance, revenues and transfers—of \$125.8 billion and expenditures of \$122.6 billion. Based on the proposed budget, the General Fund would end the 2016-17 year with an unencumbered reserve of over \$2.2 billion and include the deposit of \$3.6 billion to the Budget Stabilization Account (BSA), resulting in an expected balance in this account of over \$8.0 billion. The budget also includes the continuation of established efforts to pay down budgetary debt from past years, and as mandated by the passage of Proposition 2 in November 2014. The fiscal position of the 2016-17 budget benefits from past years of spending restraint, temporary taxes approved by the voters in 2012, a significantly improved state economy, and a growing revenue base.

As a result of the combined efforts of the Administration and the Legislature, 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 2015-16 adopted budget, revenues are up by about \$5.9 billion over the three year period (past year, current year and budget year). The General Fund's comparative health follows-on from last year's good budgetary news. The proposed 2016-17 budget builds from this solid base, incorporating a general reserve and BSA of approximately \$10.2 billion (with another almost \$1.0 billion reserved for encumbrances). Overall, General Fund spending in 2016-17 is expected to grow in percentage terms by 5.6 percent from 2015-16 to 2016-17, attributable largely to health and human services, education, and government operations.

**OVERVIEW OF GOVERNOR’S BUDGET PROPOSAL**

The Governor’s budget includes \$125.8 billion in General Fund revenues and other resources and \$122.6 billion in total General Fund expenditures (\$71.6 billion in non-Prop 98 and \$51.0 billion in Proposition 98), providing for a \$2.2 billion unencumbered reserve, as well as setting aside an additional \$3.6 billion in the BSA. Expenditures in 2016-17 are proposed to be about \$6.5 billion higher than revised 2015-16 expenditures. Significant additional funding is proposed for K-14 education, health and human services, and debt repayment, with some increases for most other areas of the budget. The budget generally includes slight program expansions and workload-related increases. This growth is made possible as a result of positive revenue growth based on continued economic improvements in the state. The General Fund budget details are summarized in the table below.

<b>2015-16 and 2016-17 General Fund Summary (Dollars in Millions)</b>		
	<b>Revised 2015-16</b>	<b>Proposed 2016-17</b>
<b>PRIOR YEAR BALANCE</b>	\$3,699	\$5,172
Revenues and transfers	\$117,537	\$120,633
<b>TOTAL RESOURCES AVAILABLE</b>	<b>\$121,236</b>	<b>\$125,805</b>
Non-Proposition 98 Expenditures	\$66,072	\$71,637
Proposition 98 Expenditures	\$49,992	\$50,972
<b>TOTAL EXPENDITURES</b>	<b>\$116,064</b>	<b>\$122,609</b>
<b>FUND BALANCE</b>		
Encumbrances	\$966	\$966
Special Fund for Economic Uncertainties	\$4,206	\$2,230
<b>BUDGET STABILIZATION ACCOUNT</b>	<b>\$4,455</b>	<b>\$8,011</b>

**CURRENT-YEAR BUDGET HIGHLIGHTS AND UPDATE**

Working from the general basis of the Governor's budget and May Revision, for the current year budget, 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 2015 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 \$1.1 billion general reserve.

**Expenditure Highlights.** The current budget represents a comprehensive approach to gradually restoring essential educational, human services, and health programs, while maintaining the state's solid fiscal outlook. Specifically, the budget funding plan provides resources for many of the Legislature's priorities—especially in the areas of child care, human services, health, and higher education—within the established framework. The architecture for the plan began with much of the Governor's base level funding, but incorporated distinctive and important changes in program spending that reflect the Legislature's priorities.

- **K-14 Education.** The budget continues the state's rapid reinvestment in education. The Proposition 98 funding guarantee (comprising General Fund and local property tax revenues) for K-14 schools was \$56.6 billion in 2007-08, but dropped to \$47.3 billion in 2011-12 as a result of revenue declines largely attributable to the recession. Since then, funding has increased regularly, to \$68.4 billion in 2015-16. The Proposition 98 maintenance factor (an indicator of the past cuts made to schools and community colleges) totaled nearly \$11.0 billion as recently as 2011-12, but is reduced to just \$772 million in the 2015-16 budget. This reinvestment provides for continued implementation of the Local Control Funding Formula (LCFF) well ahead of schedule. When the formula was adopted in 2013-14, funding was expected to be \$47.0 billion in 2015-16. The budget provides \$6.0 billion more, with an allocation of \$53.0 billion this coming year. One-time Proposition 98 funding of \$3.8 million is provided to pay K-14 mandate claims. Additional funds are available for career technical education, adult education, educator support, special education and K-12 internet access.
- **Child Care and Early Education.** A centerpiece of the Legislature's priorities is early childhood education, where the budget invests an increase of \$423 million (\$220 million Proposition 98 General Fund and \$203 million General Fund) to improve access and strengthen quality. The budget provides 13,380 new slots (\$133 million) for full-day state preschool and voucher-based programs, and increases several reimbursement rates (\$163 million [\$44 million Proposition 98 and \$119 million other funds]), including: rates for State Preschool and other providers that directly contract with the Department of Education, rates for voucher-based child care providers, and rates for license-exempt providers.
- **Higher Education.** The budget maximizes the state's dollars in opening up opportunities for Californians by investing in quality, affordability, and increased access at the state's higher education systems. To maintain affordability, the budget holds tuition for California undergraduate students flat through 2016-17. It includes \$217 million in new ongoing

funding for the California State University (CSU) and provides \$120 million in new ongoing funding for the University of California (UC). For UC, it also provides temporary funding from Proposition 2 funds to assist in paying down UC's unfunded pension liability. For California Community Colleges (CCC), the budget provides \$100 million for investing in student success, as well as more resources for full-time faculty and basic skills efforts.

- **Water Policy and Drought Response.** California has experienced four consecutive years of below-average rain and snow, and is currently facing severe drought conditions in all 58 counties. Since a state of emergency was declared on January 2014, the Legislature and the Administration have worked to assist drought-impacted communities and fund critical water infrastructure projects that will make the state more resilient if the drought continues. The 2015 Budget Act includes an additional \$1.8 billion of one-time resources to continue the state's response to drought impacts. The funds will protect and expand local water supplies, conserve waters and respond to emergency conditions.
- **Cap-and-Trade Expenditures.** The adopted budget for 2015-16 includes staff resources necessary to continue existing workload related to cap-and-trade expenditures, but rejects all of the discretionary expenditure proposals, so that discussions between the Legislature and the Administration can continue in order to further refine the state's expenditure plan for the 40 percent of the cap-and-trade revenues that are not continuously appropriated pursuant to statutes enacted last year.
- **Earned Income Tax Credit.** The budget includes an Earned Income Tax Credit (EITC) for the benefit of low-income wage earners. The targeted credit provides a refundable tax credit totaling \$380 million, and focuses on households with incomes less than \$6,580, if there are no dependents, and up to \$13,870, if there are three or more dependents. The credit matches 85 percent of the federal credit, at the lowest income levels, with a maximum benefit of \$2,653. Unlike the federal program, the state EITC is subject to annual appropriation, depending on budgetary conditions.

**Recent Developments.** Since the adoption of the 2015 Budget Act, there have been numerous moderate spending adjustments, as well as significant improvements from the revenues adopted in the budget. The most significant change is the additional \$1.0 billion deposit to the BSA and additional debt pay-down, based on higher personal income tax receipts. The differences between the adopted and revised current year budget are presented in the following table.

**General Fund Expenditures**  
**Current Year Adopted and Revised**  
**(Dollars in Millions)**

<b>Program Area</b>	<b>Adopted 2015-16</b>	<b>Revised 2015-16</b>	<b>Change</b>	<b>Percent Change</b>
K-12 Education	\$49,373	\$49,859	\$486	1.0%
Higher Education	14,200	14,312	112	0.8%
Health and Human Services	31,867	31,666	-201	-0.6%
Corrections and Rehabilitation	10,078	10,276	198	2.0%
Business, Consumer Services, Housing	627	636	9	1.4%
Transportation	261	267	6	2.3%
Natural Resources	2,479	2,730	251	10.1%
Environmental Protection	69	325	256	371.0%
Labor and Workforce Development	214	212	-\$2	-0.9%
Government Operations	738	761	23	3.1%
General Government				
Non-Agency Departments	684	711	27	3.9%
Tax Relief / Local Government	469	445	-24	-5.1%
Statewide Expenditures	1,152	637	-515	-44.7%
Legislative, Judicial and Executive	3,158	3,227	69	2.2%
<b>Total</b>	<b>\$115,369</b>	<b>\$116,064</b>	<b>\$695</b>	<b>0.6%</b>

## 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 largest dollar changes in expenditures from 2015-16 by program are in health and human services, governmental operations, and K-12 education.

### General Fund Expenditures Current and Budget Year (Dollars in Millions)

Program Area	Revised 2015-16	Proposed 2016-17	Change	Percent Change
K-12 Education	\$49,859	\$51,230	\$1,371	2.8%
Higher Education	14,312	14,567	255	1.8%
Health and Human Services	31,666	33,742	2,076	6.6%
Corrections and Rehabilitation	10,276	10,620	344	3.3%
Business, Consumer Services, Housing	636	434	-202	-31.8%
Transportation	267	222	-45	-16.9%
Natural Resources	2,730	2,909	179	6.6%
Environmental Protection	325	-31	-356	-109.5%
Labor and Workforce Development	212	166	-46	-21.7%
Government Operations	761	2,245	1,484	195.0%
General Government				
Non-Agency Departments	711	729	18	2.5%
Tax Relief / Local Government	445	483	38	8.5%
Statewide Expenditures	637	1,963	1,326	208.2%
Legislative, Judicial and Executive	3,227	3,330	\$103	3.2%
<b>Total</b>	<b>\$116,064</b>	<b>\$122,609</b>	<b>\$6,545</b>	<b>5.6%</b>

The Governor's budget proposes some major policy and budgetary changes. Some of the highlights of the budget proposal are outlined below:

#### Education

- **Pre-K 14 Funding Levels.** The budget proposes to continue investments in both K-12 schools and higher education. Proposition 98 investments in K-14 education increase almost \$5.4 billion over the three-year period of 2014-15 through 2016-17.
- **Early Education.** The budget proposes to restructure funding for preschool programs through the creation of a new \$1.6 billion block grant that allows Local Educational Agencies to more flexibly meet the needs of their pre-kindergarten populations and benefit low-income and at-risk preschoolers. This block grant combines Proposition 98 funding previously allocated for preschool and transitional kindergarten programs.

- **K-12 Schools.** Per student funding levels (from all fund sources) will increase to \$14,550 in 2016-17 from \$14,184 in 2015-16 (and from \$13,637 in 2014-15). Proposition 98 funding will increase from \$66.7 billion in 2014-15 to \$69.2 billion in 2015-16 to \$71.6 billion in 2016-17. Rising state revenues means that the state can continue implementing the Local Control Funding Formula ahead of schedule. The budget provides almost \$6 billion more in transition funding (\$2.8 billion in 2016-17) than was projected when the formula was adopted in 2013-14. The allocation of almost \$55.5 billion this coming year results in funding approximately 95 percent of the formula.
- **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 and is designed to facilitate cooperation between and among community colleges and university systems to help ensure students complete their degrees in a timely manner.

### Human Services

- **SSI/SSP Cost-of-Living.** The budget proposes a cost-of-living adjustment increase to the SSP portion of the SSI/SSP grant of \$40.7 million General Fund, effective January 1, 2017. Together with a federal increase in the SSI portion, this will result in a monthly increase of \$17 for individuals and \$31 for couples. The full year cost of the proposed adjustment is estimated to be \$82.3 million General Fund.

### Health Care

- **Managed Care Organization Tax.** The state's current managed care organization tax (MCO) offsets about \$1 billion expenditures annually and is effective through June 20, 2016. Last year, in response to updated federal guidance on the design of these types of taxes, the Governor proposed an extension of a revised version of this tax; however, the Legislature did not approve the Administration's proposal. The Governor called a special session to address the extension of this tax (and discuss rate increases for providers of Medi-Cal and developmental disability services).

The budget proposes a new tax reform package to extend the MCO. This new tax reform package now includes reforms in the gross premiums tax and corporation tax, which were not previously part of the proposal. As a result, this tax reform package reduces the tax liability for the health plan industry.

The new proposal nets about \$1.35 billion in tax revenue for the state which would be deposited into a special fund. The Administration proposes to use \$236 million of this revenue to restore the seven percent reduction to In-Home Supportive Services. The remaining tax revenue (about \$1.1 billion) is unallocated and in the special fund reserve. The Administration notes its expectation that any additional targeted rate increases for services and supports to persons with developmental disabilities (above what is proposed in the budget) would be funded by the MCO revenue.

### Public Safety and Judiciary

- **Local Jail Construction.** The budget proposes \$250 million General Fund for those counties that have either received partial funding or no funding from the \$2.2 billion in lease-revenue bond funding that the state has provided over the last several years for replacing or renovating county jails.
- **Judicial Branch.** The budget includes total funding of \$3.6 billion (\$1.7 billion General Fund) for the Judicial Branch, of which \$2.8 billion is provided in support of trial court operations. This represents a \$175 million increase over 2014-15 expenditures.

### Resources and Environment

- **Cap-and-Trade Revenues.** The budget proposes to invest \$3.1 billion of cap-and-trade auction revenue proceeds, which includes the balance of the 2015-16 proceeds that were not appropriated in 2015-16 and the proceeds anticipated in 2016-17, in addition to a \$500 million reserve. Specifically, this includes \$1.2 billion continuously appropriated for transportation and sustainable communities, \$1.0 billion for petroleum use reduction, \$215 million to reduce short-lived climate pollutants, \$200 million for carbon sequestration and healthy forests, \$200 million for energy efficiency and renewable energy programs, \$150 million for water efficiency, drought response and wetland restoration, and \$100 million for a new program to support local climate actions in the state's top five percent of disadvantaged communities.
- **Continued Drought Response.** The budget calls for \$323 million to continue drought-relief efforts, including \$160 million for continued emergency response. Major proposals include \$77 million for enhanced fire protection, \$22 million for disaster assistance, and \$17 million for fish rescue and enhancement.
- **Marijuana Cultivation Enforcement.** As part of a broader approach to marijuana cultivation enforcement, and including funding provided by the Medical Marijuana Regulation and Safety Act of 2015, the budget provides funding and positions to various regulatory departments to provide environmental protection from medical marijuana cultivation.

### Fiscal Management

- **Budget Reserve Deposits.** As an integral part of the proposal, the budget includes measures that would result in additional reserves for economic uncertainties. The deposit to the Budget Stabilization Account (BSA), redefined by Proposition 2, will total \$3.6 billion, which includes a supplemental payment above the required amount of \$2.0 billion. The proposal will result in a balance in the account at the conclusion of 2016-17 of \$8.0 billion, when combined with prior deposits to the fund, and would result in the BSA being funded to 65 percent of the maximum level.

- **Debt Repayments.** The budget continues to pay down the debt overhang as required under Proposition 2. Under the proposal, \$1.6 billion in Proposition 2 funds will pay off loans from special funds and past Proposition 98 liabilities. The payments include: \$955 million for budgetary borrowing from special funds, \$257 million for Proposition 98 settle-up costs, \$173 for pre-Proposition 42 transportation loans, and \$171 million for University of California retiree health.

### Infrastructure

- **Transportation Infrastructure.** The budget proposes \$1.7 billion in 2016-17, and \$3.6 billion on an annual ongoing basis, for transportation funding and reform. The annual funding package provides \$2.0 billion from a new \$65 fee on all vehicles; \$500 million by setting the gasoline excise tax at 18 cents (includes future adjustments for inflation); \$500 million from an 11-cent increase in the diesel excise tax; \$500 million in additional cap-and-trade proceeds; and \$100 million from cost-saving reforms to be implemented by Caltrans. The \$1.7 billion of additional funding in 2016-17 includes \$173 million from the acceleration of General Fund loan repayments over the next four years (\$879 million total), rather than repaying these loans over the next 20 years. The additional funding will be used for local streets and roads, a new low carbon road program, transit and intercity rail capital projects, highway maintenance, and trade corridors.
- **Statewide Infrastructure Investments.** The budget proposes a \$1.5 billion transfer from the General Fund to a new State Office Infrastructure Fund to be used for deferred renovation, or replacement of, state office buildings in the Sacramento region. The budget also includes a one-time \$807 million package (\$500 million General Fund, \$289 million Proposition 98 General Fund, and \$18 million Motor Vehicle Account) to address the most critical deferred maintenance needs. The largest components of this are: \$289 million for community colleges, \$100 million for levee repairs, \$64 million for state hospitals, \$60 million for the judicial branch, \$60 million for parks and recreation, \$55 million for corrections and rehabilitation, and \$35 million each for UC and CSU.

## 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 growth in the economy, and accompanying increases in state revenues. The state's recovery has continued as a result of better real estate conditions, steady job growth, and improved consumer attitudes. Nationally, concerns remain about comparatively low rates of labor participation as well as rather anemic growth in wages and salaries. In California, however, personal income is growing faster than expected, and should continue to in 2016 and 2017. The Administration's economic forecast assumes that the current moderate economic recovery (annual growth of somewhat below three percent) will continue in 2016, leading to broad-based improvements in both the U.S. and California economies over the next two years.

The Administration expects job growth to improve, with employment projected to grow 2.5 percent in 2015 and 2.5 percent in 2016. Based on its November 2015 *Fiscal Outlook*, the LAO estimate is in the same range, with projected growth rates in employment of 3.0 percent and 2.5 percent for these two years. The Governor's budget assumes a continued improvement in personal income with increases of 5.3 percent in 2015 and 5.5 percent in 2016. The LAO sees somewhat greater growth in personal income in 2015, with an increase of 5.8 percent, and an increase of 5.8 percent in 2016. LAO indicates an unemployment rate of 6.0 percent in 2015, dropping to 5.4 percent by the end of 2016. Overall, the Administration's and LAO's economic forecasts are generally congruent.

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. Nevertheless, the Administration notes two major risks to the economic forecast—a slowdown in the global economy and a stock market correction. Regarding the economic slowdown, China's growth rate slowed in 2015 and there is some uncertainty regarding the growth path of the European Union. With respect to the stock market, volatility remains high and the value of technology stocks has outpaced the economic growth rate. Especially in recent weeks, the market has been volatile and lost a certain amount of ground from its 2015 high.

**General Fund Revenues.** California relies on a broad range of taxes and other revenues to support the activities of the General Fund; however, just three taxes—personal income tax, sales and use tax, and corporation tax—account for over 97 percent of General Fund revenues. For the budget year, the personal income tax is expected to generate \$83.8 billion (68 percent), the sales

and use tax \$25.9 billion (21 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 tax grows in the budget year.

Over the three year period, General Fund revenues are up by approximately \$5.9 billion from the 2015 Budget Act. From the current year to budget year, the major revenue sources are expected to grow by 3.1 percent for the personal income tax, 2.8 percent for the sales and use tax, and 6.3 percent for the corporation tax. Overall year-to-year revenue growth is estimated to be 3.2 percent. The table below presents the state’s General Fund revenues for the current and budget year.

**General Fund Revenues  
Current Year Revised and Budget Year Forecast  
(Dollars in Millions)**

Revenue Source	2015-16	2016-17	Change	Percent Change
Personal Income Tax	\$81,354	\$83,841	2,487	3.1%
Sales and Use Tax	25,246	25,942	696	2.8%
Corporation Tax	10,304	10,956	652	6.3%
Insurance Tax	2,493	2,549	56	2.2%
Alcohol Beverage Tax	366	373	7	1.9%
Cigarette Tax	84	81	-3	-3.6%
Motor Vehicle Fees	22	22	0	0.0%
Other Taxes and Fees	517	425	-92	-17.8%
<b>Subtotal</b>	120,386	124,189	3,803	3.2%
Transfer to BSA	-2,849	-3,556	-707	24.8%
<b>Total</b>	<b>\$117,537</b>	<b>\$120,633</b>	<b>\$3,096</b>	<b>2.6%</b>

# SUBCOMMITTEE NO. 1

## EDUCATION

### **K-14 Education**

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# 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 more than 1,200 charter schools throughout the state, as well as 72 community college districts, 113 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 proposed 2016-17 budget includes funding at the Proposition 98 minimum guarantee level of \$71.6 billion. The budget proposal also revises the 2015-16 Proposition 98 minimum guarantee to \$69.2 billion, an increase of \$766 million from the 2015 Budget Act, and revises the 2014-15 Proposition 98 minimum guarantee to \$66.7 billion, an increase of \$387 million from the 2015 Budget Act. The Governor also proposes to pay \$257 million in Proposition 98 settle-up towards meeting the 2009-10 Proposition 98 minimum guarantee. Together, the increased guarantee levels and settle-up payments reflect a total of \$4.3 billion in increased funding for education over the three years, as compared to the 2015 Budget Act.

The Governor proposes to use one-time Proposition 98 funds to provide discretionary funding that will also help to reduce the mandate backlog, as well as to fund one-time programs, like the career technical education incentive grant program that was included in the 2015 Budget Act. 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 career technical education for community colleges, early education, and special education, among others. These proposals are more fully described later in this section and in separate sections of this report.

**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. Non-Proposition 98 education funds largely 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 also 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 in General Fund.

**Proposition 98 Funding  
Sources and Distributions  
(Dollars in Millions)**

	Pre-Recession 2007-08	Low Point 2011-12	2012-13	2013-14	Revised 2014-15	Revised 2015-16	Proposed 2016-17
<b>Sources</b>							
General Fund	42,015	33,136	41,682	42,996	49,554	49,992	50,972
Property taxes	14,563	14,132	16,224	15,905	17,136	19,183	20,613
<b>Total</b>	<b>56,577</b>	<b>47,268</b>	<b>57,907</b>	<b>58,901</b>	<b>66,690</b>	<b>69,175</b>	<b>71,585</b>
<b>Distribution</b>							
K-12	50,344	41,901	51,719	52,392	60,620	62,567	64,827
CCC	6,112	5,285	6,110	6,430	5,990	6,526	6,675
Other	121	83	78	78	80	82	83

Source: Legislative Analysts’ Office and Department of Finance

**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 calculates 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 calculates 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**

Test	Calculated Level	Operative Year	Times Used
Test 1	Based on a calculated percent of General Fund revenues (currently around 38.1%).	If it would provide more funding than Test 2 or 3 (whichever is applicable).	4
Test 2	Based on prior year funding, adjusted for changes in per capita personal income and attendance.	If growth in personal income is $\leq$ growth in General Fund revenues plus 0.5%.	14
Test 3	Based on prior year funding, adjusted for changes in General Fund revenues plus 0.5% and attendance.	If statewide personal income growth $>$ growth in General Fund revenues plus 0.5%.	9

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 2016-17, the Proposition 98 guarantee is calculated under Test 3, the current year is a Test 2 year, and prior year is a Test 1. A Test 3 is reflective of strong per capita personal income growth in comparison to relatively lower General Fund growth. 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). In a Test 3 year, the Proposition 98 minimum guarantee does not grow as fast as in a Test 2 year, in recognition that the state’s General Fund is not reflecting the same strong growth as personal income and the state may not have the resources to fund at a Test 2 level, however a maintenance factor is created as discussed in more detail later. 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.** When the state suspends the Proposition 98 minimum guarantee or Test 3 is operative (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 state 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, when the maintenance factor payment is approximately \$5.4 billion.

The Governor’s proposal includes maintenance factor payments of \$810 million in the 2015-16 year, completely paying off the outstanding maintenance factor balance. However, in 2016-17, the Governor’s proposal projects a Test 3 year and the creation of \$548 million in maintenance factor owed in future years.

**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, 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 \$362 million in 2014-15 and

\$814 million in 2015-16 (due to increases in the guarantees for those years.) The Governor's budget proposal also includes a settle-up payment of \$257 million counting towards the 2009-10 minimum guarantee. After this payment, the state would owe \$975 million in settle-up for years prior to 2014-15.

**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 twice, spikes in revenues in the 2012-13 and 2014-15 years, resulted in spike protection reducing the impact of these revenue gains on the 2013-14 and 2015-16 minimum guarantees, respectively.

**Proposition 98 Rainy Day Fund and District Reserve Caps.** Proposition 2 passed in the November 4, 2014 general election and requires certain debt payment and reserve deposits in some years. As part of these reserve requirements, a deposit in a Proposition 98 Rainy Day Fund is required under certain circumstances. These conditions are that maintenance factor (accumulated prior to 2014-15) is paid off, that Test 1 is in effect, that the Proposition 98 guarantee is not suspended, and that no maintenance factor is created. Related statute requires that in the year following a deposit into this fund, a cap on local school district reserves would be implemented. Both the Governor and the Legislative Analyst's Office (LAO) continue to project that a Test 1 will not be in effect in their forecast period over the next few years. The conditions needed to trigger Test 1 include significant year-over-year revenue gains that are unlikely given the modest growth projections and potential for a slowing economy in the near future.

**Outstanding Obligations.** The state currently has paid most of the outstanding obligations to school districts and community colleges that built up over the last recession. However, as of the 2015 Budget Act, the state still has nearly \$2.6 billion in unpaid mandate claims. The Governor's proposal for 2016-17 would retire approximately \$786 million of these mandate obligations.

## GOVERNOR'S PROPOSAL

**K-14 Proposition 98 Education Overall.** The budget estimates that the total Proposition 98 guarantee (K-14) for 2014-15 increased by \$387 million, compared to the level estimated in the 2015 Budget Act. Similarly, for 2015-16, the Governor estimates an increase in the total guarantee of \$766 million. 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 provide discretionary funding to LEAs, a portion of which would reduce the backlog of mandate claims. The budget estimates a total Proposition 98 funding level of \$71.6 billion (K-14). This is a \$3.2 billion increase over the 2015-16 Proposition 98 level provided in the 2015 Budget Act.

**K-12 Education Proposition 98 Major Spending Proposals.** The budget includes a proposed Proposition 98 funding level of approximately \$63.2 billion for K-12 programs. This includes a year-to-year increase of more than \$2.1 billion in Proposition 98 funding for K-12 education, as

compared to the revised Proposition 98 K-12 funding level for 2015-16. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from \$10,223 provided in 2015-16 to \$10,591 in 2016-17. This 2016-17 proposed funding level in Proposition 98 funds for K-12 reflects a per-pupil increase of 3.5 percent, as compared to the revised per-pupil funding level provided for 2015-16. The Governor's major K-12 spending proposals are identified below. (For more information on the Governor's budget proposals for the California Community Colleges, please see the *Community College Workforce Initiative Technical Education* section of this report.)

- **K-12 Local Control Funding Formula.** The 2013 Budget Act changed how the state provides funding to school districts and county offices of education by creating the Local Control Funding Formula (LCFF). The budget proposes an increase of approximately \$2.8 billion to implement the LCFF. This investment would eliminate about 50 percent of the remaining funding gap between the formula's current year funding level and full implementation for school districts and charter schools. Overall, this investment results in the formula being 95 percent fully funded in 2016-17. County offices of education reached full implementation with the LCFF allocation in the 2014 Budget Act. The accountability system for LCFF is also not yet fully implemented. Implementation of LCFF is more fully discussed in *K-12 Education Reform: Finance, Accountability, and Standards* in this report.
- **Mandate Backlog Reduction.** The budget proposes more than \$1.2 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, while the use of this funding is discretionary, it allows school districts, charter schools, and county offices of education to continue to invest in implementing state adopted academic content standards, upgrade technology, provide professional development, support beginning teacher induction and address deferred maintenance projects.
- **Enrollment and Cost-of-Living Adjustments.** The proposed budget reflects an estimated decrease in student enrollment in the K-12 system. Specifically, it reflects a decrease of \$150.1 million in 2015-16, as a result of a decrease in the projected average daily attendance (ADA), as compared to the 2015 Budget Act. For 2016-17, the budget reflects a decrease of \$34.1 million to reflect a projected decline in ADA for the budget year. The budget also proposes an increase of \$61 million in Proposition 98 funds to reflect an increase in charter school ADA. The proposed budget also provides \$22.9 million to support a 0.47 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 budget does not include a specific K-12 school facilities proposal, but notes continued concerns with the existing program, including but not limited to, program complexity, costly administrative burdens, inequalities in funding allocation, and lack of alignment with actual local facility needs. The Administration acknowledges that a new program is needed, but states that the \$9 billion school bond on the November 2016 ballot fails to make needed changes, while adding significant debt service costs. The

Administration proposes to continue the dialogue with the Legislature and stakeholders 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.

### Other K-12 Education Budget Proposals

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

- **Charter School Startup Grants.** The budget proposes to allocate \$20 million in one-time Proposition 98 funds to provide start-up grants for new charter schools. In previous years, new charter schools were eligible for start-up funding through the federal Public Charter Schools Grant program. California was not selected to participate in the latest cohort of this grant program.
- **K-12 High Speed Network.** The budget proposes \$8 million Proposition 98 funds (\$4.5 million ongoing and \$3.5 million one-time) to support the operations of the K-12 High Speed Network. The 2015 Budget Act required the program to use existing reserves to fund operations in 2015-16.
- **Proposition 47.** The budget proposes \$7.3 million in Proposition 98 funding to support improved outcomes for students who are truant, at risk of dropping out of school, or are victims of crimes. Proposition 47 reduced penalties for some crimes and required that 25 percent of the resulting savings be invested in K-12 truancy, dropout prevention, victim services, and drug and mental health treatments.
- **Systems of Learning and Behavioral Supports.** The budget proposes to allocate \$30 million in one-time Proposition 98 funds to support an effort (beginning in 2015-16 with \$10 million in one-time Proposition 98 funds) to help LEAs establish and implement schoolwide systems of academic and behavioral support for students.
- **Proposition 39 Energy Efficiency Investments.** The budget proposes to allocate \$419 million in Proposition 39 energy funds available in 2016-17 as follows:
  - \$365.4 million to K-12 school districts, for energy efficiency project grants.
  - \$45.2 million to community college districts, for energy efficiency project grants.
  - \$5.4 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.
- **Special Education.** The budget proposes a decrease of \$15.5 million in Proposition 98 funds to reflect a decrease in special education ADA.

- **Child Care and Development.** The budget provides \$3.6 billion total funds (\$948 million federal funds; \$1.7 billion Proposition 98 General Fund; and \$998 million non-Proposition 98 General Fund) 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.** Unlike prior years, the budget does not include significant new programs in the area of K-12 education. Most new ongoing funds are committed to further implementation of the LCFF, a commitment the state made beginning in the 2013-14 fiscal year. The Legislature should continue to monitor progress towards full implementation of the LCFF and understand the continued investment over the next few years that will be needed to reach funding targets. This investment is important for the way the state is funding K-12 education, but also takes the bulk of ongoing Proposition 98 resources. As the large state revenue gains and corresponding Proposition 98 growth we have seen in the past few years slows, it will be critical to understand both how new revenue growth and expenditure changes within the guarantee can continue to be tapped for the LCFF over the next few years. The accountability part of this funding formula is also key for the Legislature to ensure that education resources are directed where they are needed most (see section *K-12 Education Reform: Finance, Accountability, and Standards* for a detailed discussion of the LCFF and accountability).

Ultimately, the Legislature should prioritize expenditure of limited ongoing funding to align with and support the Legislature's priority K-12 education policies. These may include supporting continued implementation of LCFF and building capacity for a robust accountability system. This could also include strategic smaller investments in program areas outside of the LCFF, such as the continuing implementation of state standards, support for special education, and targeted investments in improving student outcomes.

**Availability and Use of One-Time Funds.** The LAO and the Department of Finance are in general agreement on revenue projections and the calculation of the Proposition 98 guarantee in 2016-17. This is a considerable change from past years when the LAO projected significant revenue gains above what the Governor proposed in January. In the past, K-14 education has benefited significantly from new revenues, in particular, the Proposition 98 guarantee in 2014-15 created a situation where any new revenue went directly to funding education. This resulted from the combination of a Test 1 being in effect and large maintenance factor payments. When the numbers were trued up at the May Revision, significant pots of new one-time funds were then identified for expenditure within the Proposition 98 guarantee. However, with changes to the 2014-15 fiscal year less likely, and the 2015-16 guarantee calculation (and as a result later years) being less sensitive to revenue changes, significant one-time funding may not materialize in future budgets. The Governor has proposed to use of much of the current one-time funding for discretionary purposes, while scoring some benefit to the state by paying off a portion of the K-12 mandates backlog. However, given that this may be the last year with this amount and type of funding available, the Legislature may wish to target some of the one-time funds for strategic investments that K-14 education entities can build on using existing ongoing funding, such as standards implementation or building capacity for supporting the new accountability system.

# K-12 Education Reform: Finance, Accountability, and Academic Standards

## BACKGROUND

The K-12 education system in California is undergoing a transformation; structural reform in the financing system aligns with and drives reform in accountability for student outcomes through the adoption and implementation of the Local Control Funding Formula (LCFF). In addition, fundamentally in the classroom, new statewide curriculum standards have been adopted for the classroom and are in the process of being implemented. These new standards replace those that had been in place since the late 1990s and include significant changes in how students are taught. Although these changes began several years ago, this transformation is by no means complete. The K-12 education funding allocation is still transitioning to a new formula basis, accountability systems are still in development, and locally, teachers and administrators are still aligning teaching and learning to correspond to new state academic standards.

### **K-12 School Finance Reform**

As of the 2015 Budget Act, the state appropriates more than \$60 billion in Proposition 98 funding (General Fund and local property taxes) annually for K-12 public schools. In 2013-14, the state significantly reformed the system for allocating funding to school districts, charter schools, and county offices of education. The 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 a unique allocation methodology, spending restrictions, and reporting 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.

**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.

**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. It also includes additional funding, based on the enrollment of low-income students, English learners, and foster youth, provided for increasing or improving services to these high-needs students. Low-income students, English learners, and foster youth students are referred to as “unduplicated” students in reference to the LCFF because for the purpose of providing supplemental and concentration grant funding, these students are counted once, regardless of if they fit into more than one of the three identified high-need categories. Major components of the formula are briefly described below.

- **Base Grants** are calculated on a per-student 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 the percentage of enrollment that is made up of unduplicated students.
- **Concentration Grants** provide an additional 50 percent above base grant funding for the percentage of unduplicated students 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 90<sup>th</sup> 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 under the old system.

**County Offices of Education Formula.** The County Offices of Education (COE) formula is very similar to the school district formula, in terms of providing base grants, plus supplemental and concentration grants for the students that COEs serve directly, generally in an alternative school setting. However, COEs also receive an operational grant that is calculated based on the number of districts within the COE and the number of students county-wide. This operational grant reflects the additional responsibilities COEs have for support and oversight of the districts and students in their county.

**Budget Appropriations.** The LCFF establishes new “target” LCFF funding amounts for each LEA, and these amounts are adjusted annually for COLAs and pupil counts. When the formula was initially introduced, funding all school districts and charter schools at their target levels was expected to take eight years and cost an additional \$18 billion, with completion by 2020-21. The Department of Finance (DOF) has not released an updated estimate of the completion date at this point. County offices of education reached their target funding levels in 2014-15 and adjust each year for COLAs and ADA growth.

Over the past three years, the state has made considerable investments towards implementing the LCFF, as shown in the table below. The 2015-16 funding closed almost 52 percent of the remaining gap to full funding of the LCFF target levels for school districts and charter schools. The remaining gap is recalculated annually based on funding provided but also on annual adjustments to the LCFF funding targets. Overall, the LCFF is about 90 percent fully funded as of the 2015 Budget Act.

**Amounts Provided in the Annual Budget to fund increased costs for LCFF  
(Dollars in Billions)**

<b>Fiscal Year</b>	<b>Original Estimated Need to Fully Fund LCFF</b>	<b>Gap Appropriation</b>	<b>Remaining Need to Fully Fund LCFF</b>
2013-14	\$18.0	\$2.1	\$15.8
2014-15	N/A	\$4.7	\$11.3
2015-16	N/A	\$6.0	\$5.3 (estimated)

Figures may not sum due to changes between years for growth and cost of living adjustments.

Source: California Department of Education

The significant ongoing allocations of funding for the LCFF was made possible by considerable growth in the Proposition 98 guarantee over the past few years. A strong economic recovery has accelerated growth in the Proposition 98 guarantee, including funding to make up for years of low growth beginning in 2008-09. For more information on changes within the Proposition 98 guarantee, see the Section “*Proposed Expenditures of Increased Proposition 98 Resources*” in this report.

**Restrictions on Supplemental Funding.** Statute requires LEAs to increase or improve services for unduplicated students 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 State Board of Education (SBE) adopted regulations governing a LEA’s expenditure of this supplemental funding that require a LEA to increase or improve services for unduplicated 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 and detail these expenditures in their local control and accountability plan (LCAP).

**K-12 Accountability Reform**

Prior to 2013-14, LEAs were held accountable in different ways for variety of programs. Each individual categorical program had its own accountability requirements, although often this was limited to accountability for the expenditure of funds in accordance with allowable uses, rather than the impact on actual student outcomes. State and federal accountability systems provided an aggregate measure of school and district performance. The state and federal accountability systems relied primarily on student assessment data. The state used the Academic Performance Index (API) constructed data from previous statewide assessments aligned to the old standards to create a performance target. School districts, schools, and student subgroups that did not meet the performance target were required to meet growth targets. The Federal accountability system uses a measure called Adequate Yearly Progress (AYP) that relies on student assessment scores, student participation in assessments, graduation rates and the API. Schools and districts that failed to meet benchmarks and make progress could be subject to interventions.

In 2013-14, the state began to transition to new assessments, aligned to new statewide academic content standards (discussed later in this section). Most student assessment scores were not available for assessments given in the spring of 2014, since the state was piloting a new assessment system. Therefore, the SBE approved a recommendation by the State Superintendent to not calculate the API for the 2014-15 year. In addition, California applied for and received a waiver of federal law exempting the state from the calculation of the AYP for some schools and districts.

This transition in test scores and, therefore, aggregate accountability scores, aligns with an evolution in what the state expects from LEAs in terms of accountability. The LCFF statute included 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. Finally, the federal Every Student Succeeds Act was adopted in December of 2015, replacing current federal requirements with a more flexible system. Details are still emerging at this time, and federal guidelines and regulations are anticipated later this year. The state is planning on aligning state and federal accountability and approving a new state plan to meet federal requirements in the fall of 2016. All of these changes call for a broader measure of accountability that incorporates multiple measures.

**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.

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). Statute also established a process for districts to receive technical assistance related to their LCAPs. The SPI is authorized to intervene in a district that is failing to improve outcomes for students after receiving technical assistance.

**Evaluation Rubrics.** The SBE is required to adopt evaluation rubrics by October of 2016. Rubrics are tools that evaluate performance, based on specified criteria. Specifically, the evaluation rubrics developed by the SBE will: (1) assist local educational agencies (LEAs) in evaluating their strengths, weaknesses, and areas that require improvement; (2) assist county superintendents of schools in identifying LEAs in need of technical assistance and providing resources for technical assistance; and (3) assist the Superintendent of Public Instruction (SPI) in identifying LEAs for which technical support and/or intervention is warranted. Statute further requires that the evaluation rubrics provide for a multidimensional assessment of district and schoolsite performance, including adopting standards for improvement in each of the state priority areas. The SBE adoption deadline was extended by one year through the education trailer bill, AB 104 (Committee on Budget and Fiscal Review), Chapter 13, Statutes of 2015, as the SBE's process for development and stakeholder vetting of the rubrics revealed that additional time was needed to ensure rubrics are research-based and can be implemented as a key piece of a new accountability system.

Evaluation rubric progress is a part of each SBE meeting as the deadline for approval is moving closer. The most recent SBE meeting in January, 2016 featured a specific example of how the

evaluation rubrics would work using a single indicator, graduation rates, as an example. The SBE also received feedback from the first round of a user acceptance testing pilot that included over 30 LEAs in a review of some components of the draft evaluation rubrics and allowed for comment on the content and structure, standards and design, and online prototype of the evaluation rubrics system. The structure of the evaluation rubrics is based on a system used by Alberta, Canada and accounts for growth in LEA performance, performance as compared to the statewide distribution, and an overall rating. The SBE timeline shows adoption of the evaluation rubrics at their September 2016 board meeting.

**California Collaborative for Educational Excellence.** The California Collaborative for Educational Excellence (CCEE) was created as part of the new LCFF accountability framework with a role to advise and assist school districts, charter schools, and county offices of education to achieve goals in their LCAPs under the LCFF. The CCEE is required to advise and assist school districts, county offices of education, and charter schools in meeting the goals in their LCAPs. Statute allows the SPI to assign the CCEE to LEAs in need of assistance. The CCEE may contract with individuals, LEAs, or organizations with expertise in the LCAP state priority areas, improving the quality of teaching, improving school and district leadership, and addressing the needs of student populations such as unduplicated students or students with exceptional needs. 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. Although all the funds were encumbered in the 2014-15 fiscal year, to date, just \$2 million has been expended. The CCEE was officially established in 2014-15, with the first meeting of the CCEE occurring in February of 2015. Since that time, the CCEE has hired an executive director and key staff. However, the CCEE has yet to conduct any of the activities assigned under statute, as the accountability system continues to develop.

Related Legislation, SB 871 (Liu and De León), introduced January 14, 2016, would require the CCEE to conduct statewide training on the evaluation rubrics and their use to inform the LCAP with a focus on improving student outcomes and closing the achievement gap. The bill would also establish a pilot program to provide technical assistance and support to LEAs that volunteer to participate. This technical assistance will assist LEAs in improving their student outcomes but also inform the CCEE in developing its system of support and assistance for LEAs.

### **State Academic Content Standards Reform**

Although the flow of funding and the new focus on student outcomes has significantly changed K-12 education, the biggest change in the classroom has been a conversion to new academic standards. According to the California Department of Education (CDE), “content standards were designed to encourage the highest achievement of every student, by defining the knowledge, concepts, and skills that students should acquire at each grade level.” To incorporate new statewide academic content standards, the Legislature and the Governor approved legislation that requires the Superintendent of Public Instruction (SPI) to recommend, and the State Board of Education (SBE) to adopt, the standards. California first adopted academic content standards in the late 1990s for English, mathematics, science, and history-social science, pursuant to requirements in Education Code Section 60605. Additional adoptions of standards for other subject areas followed over the next decade.

In August 2010, California adopted the California Common Core State Standards in English Language Arts (ELA)/Literacy and mathematics, SB 1200 (Hancock), Chapter 654, Statutes of 2012. These new standards were developed by a coalition of states under the initiative of the National Governors Association and the Council of Chief State School Officers. The standards are based on the College and Career Readiness anchor standards that define expectations for student preparation for higher education and/or the workforce. The ELA standards include literacy standards that cross other academic content subject areas in addition to ELA.

In 2012, California adopted the California English Language Development (ELD) Standards, AB 124 (Fuentes), Chapter 605, Statutes of 2011. These standards are aligned with the California Common Core State Standards in English Language arts and describe the knowledge, skills, and abilities that English Learner students need to participate fully in the appropriate grade-level academic content. This adoption replaced the prior version of the ELD standards, adopted in 1999.

In 2013, California adopted the Next Generation Science Standards (NGSS), SB 300 (Hancock), Chapter 624, Statutes of 2011. The NGSS were developed by a coalition of states and experts in science education, led by the National Research Council, the National Science Teachers Association, and the American Association for the Advancement of Science and include the science knowledge that all K-12 students should know based on the most current science research.

**Supporting Local Implementation.** Recognizing that the state standards simply set the benchmark for what students should know, the state has also established a role in developing and providing the tools necessary for school district staff to interpret the standards and use them to guide classroom instruction. The SBE adopts curriculum frameworks for grades K-12, which the CDE describes as instruction guidelines for; “providing a firm foundation for curriculum and instruction by describing the scope and sequence of knowledge and the skills that all students are expected to master”. The frameworks are written documents developed through a public process by the Instructional Quality Commission and adopted by the SBE. The adopted frameworks are available on the CDE website. The SBE is also required to adopt an approved list of instructional materials for grades K-8 that meet state criteria, including alignment with academic standards. These instructional materials can be printed or non-printed, including digital materials. Under current law, school districts can choose instructional materials for all grades, regardless of whether or not they are on the state-adopted instructional materials list, as long as they meet state standards. The following table is a snapshot of when the state has adopted standards and related resources in each subject area.

## Adoption of State Standards and Related-Resources

Subject Area	Initial Standards Adoption	New Standards Adoption	Curriculum Frameworks	Instructional Materials
English Language Arts*	1997	2010/2013	2014	2015
English Language Development	1999	2012	2014	2015
Mathematics	1997	2010/2013	2013	2014
Science***	1998	2013	2002	2006
History Social Science	1998	N/A	2000	2005
Career Technical Education**	2005	2013	2007	N/A
Visual and Performing Arts	2001	N/A	2004	2006
Physical Education**	2005	N/A	2008	N/A
Health Education***	2008	N/A	2002	2004
Foreign/World Language***	2009	N/A	2001	2003

\*Includes Literacy Standards

\*\*Model Standards

\*\*\* Curriculum Frameworks not currently aligned with adopted standards

Source: Data from California Department of Education

**Assessments.** Student's grasp of academic content is measured at the state level by a statewide student assessment system. The system is in the process of being updated to reflect the state's adoption of new statewide content standards. Legislation, AB 484 (Bonilla) Chapter 489, Statutes of 2013, eliminated several assessments that were aligned to prior academic content standards, and provided for a transition to assessments that are aligned to the Common Core State Standards in English language arts and mathematics, English language development standards and Next Generation Science Standards. Of the statewide assessments, in 2015-16, only ELA and Mathematics are aligned to the state's most recently adopted standards, as a result of the state's participation in the multi-state Smarter Balanced Assessment Consortium (SBAC) beginning in June, 2011. In the other subject areas, new assessments are under development and until they are operational, local educational agencies will be continuing to use existing assessments, aligned to previous standards. Once fully implemented, this new suite of statewide assessments will align with new state academic content standards, but also require computer-based, and in some cases computer-adaptive, assessments to replace many assessments that were previously paper and pencil exams. The SBAC ELA and mathematics assessments are computer-adaptive assessments and require access to computing devices and the internet for the assessment to be administered.

2014-15 was the first year for which scores from the new assessments were released, and they revealed that California's student performance was low – over 50 percent statewide (55 percent in English Language Arts and 66 percent in mathematics) did not meet grade level standards and the scores revealed striking disparities in performance among different subgroups of students. These low scores were not unanticipated since the assessments were significantly different from prior assessments and scores likely reflect lack of familiarity with a new process as well as actual measurement of academic content. The new assessments are computer-adaptive, are designed to

do a better job of measuring student mastery of content, and are aligned to new standards. In addition, they include some constructed response questions as well as multiple choice questions. These scores set a new base from which the state and LEAs must grow. The second year of scores are anticipated to show growth, likely reflecting continued implementation of state standards, refinement of teaching and learning, and familiarity with a new assessment system. Scores will not be available until the fall of 2016 for assessments given in the spring of 2016.

**Funding for State Standards Implementation.** Although most categorical funding that would have previously been targeted to standards implementation was collapsed into the LCFF, the state has still provided a variety of fund sources for local implementation of statewide academic content standards:

- \$1.25 billion was provided through education trailer bill, AB 86 (Committee on Budget and Fiscal Review), Chapter 48, Statutes of 2013, to support the implementation of state adopted academic content standards. LEAs could encumber the funds in 2013-14 or 2014-15 and use the funds for (1) professional development, (2) instructional materials and (3) technology. The statute further required CDE to report on the uses of these funds. As a result, CDE released a *“Report to the Governor, the Legislature, and the Department of Finance: Local Educational Agency Expenditures of \$1.25 Billion in Common Core Implementation Funding Allocated for Fiscal Years 2012-13 and 2013-14”* detailing the expenditure categories for which LEAs opted to use the funds for. In general, the category with the highest expenditures was information technology (\$590 million), with funding primarily used for the purchase of devices and network hardware updates. Remaining funds were essentially split between professional development and instructional materials purchases. Funding by subject area was highest in the area of mathematics, mostly due to purchases of instructional materials, followed by ELA.
- The 2015 Budget Act included \$490 million in educator effectiveness funds. One of the uses prescribed by statute, AB 104, (Committee on Budget and Fiscal Review), Chapter 13, Statutes of 2015, is professional development aligned to recently-adopted statewide academic content standards.
- LEAs continue to receive funds from the state lottery and, based on Proposition 20, the Cardenas Textbook Act of 2000, a portion of these funds must be spent on instructional materials. For 2013-14 (the most recent year data on expenditures is currently available), LEAs received \$190 million in the portion of lottery funds for instructional materials.
- The state has also provided \$3.6 billion (\$400 million in 2014-15, and \$3.2 billion in 2015-16) in discretionary funding to LEAs to pay off the mandates backlog. Although this funding is discretionary, the state has suggested in intent language that the funds be prioritized for implementation of state standards among other activities.
- LEAs may also use Local Control Funding Formula (LCFF) funds for the implementation of state academic content standards.

## GOVERNOR'S PROPOSAL

The budget provides an increase of \$2.8 billion in Proposition 98 funding for schools for the fourth year of LCFF implementation. The DOF indicates this funding level represents closing approximately 50 percent of the gap between the school districts' 2015-16 funding levels and the LCFF full implementation target rates as of the budget year. Under the budget, the LCFF would be 95 percent funded in 2016-17. County offices of education, which reached full implementation in 2014-15, would receive a cost-of-living increase.

The Governor does not include a proposal specific to accountability, as the ongoing work of developing the new accountability system is underway through the leadership of the SBE. However, recognizing the extensive accountability workload that is underway by the SBE, the Governor proposes additional state operations funding of \$572,000 to fund positions and contracts for the SBE's LCFF related workload in the 2016-17 year.

The Governor does not include additional funding for statewide implementation of academic content standards, but does include an additional K-12 mandate payment of \$1.3 billion in discretionary funding for LEAs that could be used for standards implementation. (See the section entitled "*K-14 Education Mandate Claims*" in this report for more information.)

## ISSUES TO CONSIDER

**LCFF Funding Acceleration.** The budget proposes to pay down approximately 50 percent of the remaining gap between 2015-16 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? Will the state still reach full implementation in 2020-21? What investments have LEAs made with LCFF resources in the initial years of implementation?

**Accountability Systems.** The system of accountability for the state is still evolving and it will be a few years before systems are in place and LEAs and state agencies are fully trained to get the most use out of the tools being developed. Also, with this major shift to a new system, there will likely need to be a series of changes implemented in the final system. The Legislature will want to continue to monitor developments at the SBE to ensure a final system, including evaluation rubrics, LCAPs, federal ESSA requirements, and the work of the CCEE combine to provide the system of continuous improvement that was envisioned in implementing legislation. In the meantime, the Legislature may wish to ensure that training and support that needs to accompany the introduction of a new system is in place through the SBE, SPI, CCEE, and LEAs, as needed.

**State Role in Standards Implementation.** The state has adopted new academic content standards in three core subject areas (ELA, math, and science) and completion of the related curriculum frameworks and instructional materials lists are underway. With scores from statewide assessment just becoming available, the Legislature may wish to consider how to

determine when these new standards are fully implemented. Are there additional requirements related to those standards still in process, (i.e. NGSS), that may need additional action by the state? While the state has some data on the use of funds for standards implementation, it will be two more years before the state knows how LEAs spent teacher effectiveness funds, and there is currently no measure of whether LEA's are using discretionary mandates funds for standards implementation. Has the state adequately funded standards implementation? At what point is it the LEA's responsibility to budget for and use LCFF resources for the continued implementation of standards? Finally, the Legislature may wish to monitor changes in scores on statewide assessments over time as one indicator of successful standards implementation.

# K-14 Education Mandate Claims

## BACKGROUND

The concept of state reimbursement to local agencies and school districts for state-mandated activities originated with the Property Tax Relief Act of 1972, SB 90 (Dills), Chapter 1406, Statutes of 1972, known as SB 90. The primary purpose of the act was to limit the ability of local agencies and school districts to levy taxes, however it also included provisions to require the state to reimburse local governments when they incurred costs as the result of state legislation. In 1979, Proposition 4 (superseding SB 90) was passed by voters, amending the California Constitution to require local governments to be reimbursed for new programs or higher levels of services imposed by the state. In response to Proposition 4, the Legislature created the Commission on State Mandates (CSM) to hear and decide upon claims requesting reimbursement for costs mandated by the state.

In the area of K-14 education, school districts, county offices of education (COEs), and community colleges, collectively referred to as local educational agencies (LEAs), can file mandate claims to seek reimbursement. Charter schools have filed mandate claims in the past and the CSM disapproved the claims stating that a charter school is voluntarily participating in the charter program and therefore their activities are not mandates. In addition, a charter school is not considered a school district under the Government Code sections that allow for the claiming of reimbursement. However, charter schools are required, as a course of operation, to provide some of the same programs, or higher levels of service for which other education agencies may file mandate claims and receive reimbursement.

### Mandate Reimbursement Process

A test claim must be filed within 12 months of the effective date of the activity, then the CSM first determines whether an activity is a mandate. Generally, a new program or higher level of service for a local government may not be considered a reimbursable mandate if 1) it is a federally required program or service; 2) it is the result of a voter-approved measure; 3) it is the result of an optional or voluntary activity; 4) it has offsetting saving or revenues designated for that purpose; or 5) the requirement was enacted prior to 1975. The test claim must include detailed information on the enacting statutes or executive orders, mandated activities, and costs incurred as a result.

If the CSM determines the program or service to be a reimbursable mandate, the next step is for the CSM to approve "Parameters and Guidelines" that identify the eligible claimants, activities, costs, and time-period as needed for LEAs to file claims. The State Controller's Office (SCO) then issues claiming instructions and LEAs file initial claims, followed by annual claims for reimbursement. The SCO reviews, approves, and audits a sample of claims.

After the initial claims are filed for a reimbursable state mandate, the SCO aggregates these costs and provides a statewide cost estimate for adoption by the CSM. These statewide cost estimates are reported to the Legislature and used to estimate ongoing state mandate costs and the backlog of unpaid mandate claims. Below is the most recent list of active mandates for K-14 education.

**Active Education Mandates  
2014-15**

<b>K-12 Education Mandates</b>	
Academic Performance Index	Juvenile Court Notices II
Agency Fee Arrangements	Law Enforcement Agency Notification <sup>2</sup>
AIDS Prevention / Instruction	Notification of Truancy
Annual Parent Notification <sup>1</sup>	Parental Involvement Programs
CalSTRS Service Credit	Physical Performance Tests
Caregiver Affidavits	Prevailing Wage Rate
Charter Schools I, II, III, and IV	Public Contracts
Child Abuse and Neglect Reporting	Pupil Suspensions and Expulsions I and II
COE Fiscal Accountability Reporting	Pupil Health Screenings
Collective Bargaining	Pupil Promotion and Retention
Comprehensive School Safety Plans	Pupil Safety Notices
Criminal Background Checks I and II	Race to The Top
Developer Fees	School Accountability Report Cards
Expulsion of Pupil: Transcript Cost for Appeals	School District Fiscal Accountability Reporting
Financial and Compliance Audits	School District Reorganization
Graduation Requirements	Teacher Notification: Pupil Suspensions/Expulsions <sup>3</sup>
Habitual Truants	The Stull Act
High School Exit Examination	Threats Against Peace Officers
Immunization Records (includes Hepatitis B)	Uniform Complaint Procedures
Intradistrict Attendance	Williams Case Implementation I, II, and III
Interdistrict Attendance Permits	
<b>Community Colleges Mandates</b>	
Agency Fee Arrangements	Minimum Conditions for State Aid
Cal Grants	Prevailing Wage Rate
CalSTRS Service Credit	Public Contracts
Collective Bargaining	Reporting Improper Governmental Activities
Discrimination Complaint Procedures	Threats Against Peace Officers
Enrollment Fee Collection and Waivers	Tuition Fee Waivers
Health Fee Elimination	

<sup>1</sup>Includes Schoolsite Discipline Rules and Alternative Schools.

<sup>2</sup>Includes Missing Children Report.

<sup>3</sup>Includes Pupil Discipline Records.

The mandates reimbursement process has some identified shortcomings. The process often takes years for decisions to be reached, allowing potentially significant costs to accrue prior to initial claims and delaying a decision by the state to suspend or amend the requirements. Reimbursements under this process are based on actual costs; therefore LEAs may lack an incentive to perform required activities as efficiently as possible. In addition, reimbursement on an annual basis requires potentially significant bureaucratic workload for LEAs to keep required records for all of the various mandated activities. Also, depending on the amount of reimbursement available, not all LEAs may file a claim; those with less administrative capacity may simply absorb the costs of the mandate. The reverse is likely also true; LEAs with the necessary administrative resources may more aggressively pursue reimbursement, resulting in uneven funding for the same mandated activities.

In order to simplify the process, in 2004 the state created the Reasonable Reimbursement Methodology (RRM). Rather than requiring LEAs to submit detailed documentation of actual costs, RRM uses general allocation formulas or other approximations of costs approved by the CSM. Only three school mandates currently have approved RRM.

**Payment of Mandates.** Over the years, as the cost and number of education mandates has grown, the state began to defer the full cost of education mandates for multiple years at a time, paying claims on an inconsistent schedule, mostly when one-time funds are available. After deferring payments for years, in 2006, the state provided more than \$900 million in one-time funds for state mandates, retiring almost all district and community college mandate claims (plus interest) through the 2004-05 fiscal year. However on a regular ongoing basis, the state continues to defer the cost of roughly 50 education mandates, but still requires LEAs to perform the mandated activity by providing a nominal amount of money (\$1,000) for each activity.

There have been some attempts to force the state to pay mandate claims. For example, Proposition 1A, approved by the state's voters in 2004, required the Legislature to appropriate funds in the annual budget to pay a mandate's outstanding claims, "suspend" the mandate (render it inoperative for one year), or "repeal" the mandate (permanently eliminate it or make it optional). The provisions in Proposition 1A, however, do not apply to K-14 education. In addition, in 2008, a superior court found the state's practice of deferring mandate payments unconstitutional, however constitutional separation of powers means the courts cannot force the Legislature to make appropriations for mandates.

More recently the state has had significant one-time Proposition 98 funding available and has made sizeable payments towards the mandates backlog. After 2013-14, the LAO estimated that the mandates backlog reached a high of approximately \$4.5 billion. The 2014-15 Budget Act, provided \$450 million to pay K-14 mandates. The 2015-16 Budget Act, provided an additional \$3.8 billion for mandates. In both of these years, the funds were not apportioned for specific claims, but provided on an equal amount per average daily attendance (ADA) for K-12 and per full time equivalent student (FTES) for community colleges. Charter schools were also included in the per ADA allocation although they do not have mandate claims. This payment methodology acknowledges that all LEAs and community colleges were required to complete mandated activities, but for a variety of reasons, not all LEAs and community colleges submitted claims.

**Recent K-14 Mandate  
Recent Backlog Payments**

	2014 Budget Act	2015 Budget Act
<b>K-12 Education (In thousands)</b>	<b>\$400,500</b>	<b>\$3,205,137</b>
Per ADA Rate (In whole dollars)	\$67	\$529
<b>Community Colleges (In thousands)</b>	<b>\$49,500</b>	<b>\$632,024</b>
Per FTES Rate (In whole dollars)	\$45	\$556
<b>Total (In thousands)</b>	<b>\$450,000</b>	<b>\$3,837,161</b>

Does not account for leakage.

Source: Department of Finance

This payment methodology has a significant limitation in its ability to fully pay off remaining mandate claims. The per ADA and FTES methodology results in “leakage”, or the amount of the one-time payments that does not count against the mandate backlog because it was provided to LEAs or community colleges that did not submit claims or whose claims have already been paid off. As the state pays off more of the mandate backlog, the amount of leakage becomes more significant. With fewer LEAs that have remaining claims on the books, additional funding provided on a per ADA and per FTES basis has a diminishing return on reducing the backlog as the remaining claims become concentrated in those LEAs who have fewer ADA or FTES and do not generate enough funding under this methodology to pay off claims.

**Remaining Mandates Backlog.** The Administration roughly estimates that after the 2015-16 payments are applied to the mandates backlog, the remaining balance of unpaid claims totals approximately \$2.3 billion for K-12 mandates and close to \$300 million for the California Community College mandates. This includes an estimate that the \$3.8 billion provided in 2015-16 reduces mandate claims by approximately \$2.8 million. However, the SCO has not yet applied this funding to claims, so actuals are not yet available. This estimate also does not include an estimate for claims that will be reduced due to audit, but does take into account that cost estimates for the Graduation Requirements mandate will likely be reduced by offsetting revenues in the hundreds of millions. This mandate is currently involved in litigation and the SCO has not applied the CSM ruling on offsetting revenue pending completion of the lawsuit. The estimation of the actual amount of the backlog is complicated by a variety of factors, mandates claims continue to accrue on an annual basis, there is a lag in the SCO application of new one-time funds towards claims, and as a result in the calculation of leakage, claims continue to be subject to audit, and some statewide mandate costs are involved in litigation.

**Mandates Block Grant.** As an alternative to the traditional mandates claims process and to help create more certainty for LEAs in the payment of mandates, in the 2012-13 budget, the state created two block grants for education mandates: one for school districts, COEs, and charter schools (for which some mandated activities apply) and another for community colleges. Instead of submitting detailed claims that track the time and money spent on each mandated activity on an ongoing basis, LEAs can choose to receive block grant funding for all mandated activities

included in the block grant. The mandates block grant does not reflect the actual statewide costs estimates for each included mandate.

**Block Grant Funding and Participation.** The 2015-16 budget includes a total of \$251 million for the mandates block grants (\$219 million for schools and \$32 million for community colleges). Block grant funding is allocated to participating LEAs on a per-pupil basis, based on ADA or FTES. The rate varies by type of LEA and by grade span, due to the fact that some mandates only apply to high schools. The per-pupil rates are as follows:

- School districts receive \$28.42 per student in grades K-8 and \$56 per student in grades 9-12.
- Charter schools receive \$14.21 per student in grades K-8 and \$42 per student in grades 9-12.
- County offices of education (COEs) receive \$28.42 for each student they serve directly, plus an additional \$1 for each student within the county. (The \$1 add-on for COEs is intended to cover mandated costs largely associated with oversight activities, such as reviewing district budgets.)
- Community colleges receive \$28 per student.

Most school districts and COEs, and virtually all charter schools and community college districts, have opted to participate in the block grant. Specifically, in 2015-16, the LEAs participating in the block grant serve about 96 percent of LEAs, including charter schools, and 99 percent of ADA and 100 percent of community college districts, and FTES.

**New Education Mandates.** New mandate claims continue to be filed on an ongoing basis and generally, once the CSM has adopted the statewide cost estimate, this amount is added to the mandates backlog. In addition, the state must make a determination about whether to increase the mandates block grant and by what amount. Finally, if the state is not going to suspend the mandate, generally a minimal appropriation of \$1,000 is provided in the annual budget act towards the costs of the mandate. In the past, the mandates block grant has not been adjusted for low-cost mandates, but has been adjusted for high-cost mandates, such as the graduation requirements mandate, which results in an increase in the block grant in 2013-14 of \$50 million.

The CSM approved a new mandate for the required technology, training, and internet access LEAs need to provide to administer the new statewide assessments, and the California Assessment of Student Performance and Progress, beginning in 2013-14. While the CSM approved mandated activities for reimbursement in January 2016, it will be some time before the CSM process results in a statewide cost estimate.

## GOVERNOR'S PROPOSAL

The budget provides almost \$1.3 billion in one-time Proposition 98 General Fund for K-12 mandates and \$76 million for community colleges. These funds would be distributed to all school districts, charter schools, and county offices of education on a per ADA basis (approximately \$214 per ADA) and to all community colleges on a per FTES basis (approximately \$66 per FTES). While the funds are discretionary, intended to reimburse LEAs and community colleges for activities that were completed in the past, the Governor's proposal does note that funds could be used for K-12 education in the areas of academic content standards implementation, technology, professional development, beginning teacher induction programs, and deferred maintenance. For community colleges, the Governor suggests that funds could be used for one-time needs such as campus security, technology, professional development and developing open education resources, and zero-textbook-cost degrees.

Providing mandates funds on a per ADA and per FTES basis means that all LEAs, including charter schools and community colleges, would receive some funding, regardless of whether they had submitted mandate claims, or the dollar amount of their outstanding claims. As a result, the entire \$1.4 billion will not offset the mandates backlog, but rather some lesser portion of the total, as determined by the SCO. The Governor estimates this amount to be approximately \$786 million, leaving a remaining mandates backlog of approximately \$1.8 billion. The Governor continues to provide the same funding for the mandates block grant in 2016-17 as was included in the 2015 Budget Act.

## ISSUES TO CONSIDER

**The Governor's Proposed Allocation Formula is Inefficient.** Over the past two years, the state has made significant headway in paying down the mandates backlog, due to the availability of considerable one-time funding within the Proposition 98 guarantee. The approach taken thus far, providing funding to all LEAs, including charter schools, on a per student basis, regardless of which LEAs had mandate claims does provide some equity for those LEAs who did not claim due to administrative hurdles. However, the Governor's proposal to continue use of this allocation methodology results in an increasingly costly endeavor to pay down claims. Of the total \$1.4 billion proposed for 2016-17, an estimated \$786 million, or just 58 percent, reduces claims. Without a change to the methodology, in future years, it will become prohibitively expensive to use this methodology. At what point is the percentage of leakage so great, that the state should no longer pursue this type of allocation? The Legislature may wish to examine alternative allocations that would target more of the funding towards meeting the state's constitutional obligation, in the budget year, or as an option for future years.

**One-Time Resources Could Be Used for Other Education Priorities.** The Governor's proposal uses the majority of one time funding for paying down the mandates backlog by providing discretionary funding to LEAs. At the same time, the Governor suggests a variety of uses for the funding in areas of need across K-14 education. The Legislature may wish to consider if these priority areas identified by the Governor, or other areas identified by the Legislature, should benefit from targeted one-time funding to address specific needs. Funding

one-time education priorities does not need to come at the expense of meeting the state's constitutional obligation to reimburse LEAs for mandates. If the state chooses to allocate funding for the mandates backlog differently, the state could potentially pay down at least the same amount of mandates as the \$786 million estimated in the Governor's proposal and direct some resources towards other one-time activities. The state is not obligated to pay down a particular amount of mandates in any given year and may balance these payments with other needs in any given year.

**Better Estimates Would Inform Future Decision-Making.** Regardless of the approach the state ultimately chooses for allocating funds for mandates, or if the state chooses to use one-time funds on other priorities, some portion of the mandates backlog will remain and be added to over time. The system for estimation of mandates is complex, involving a lengthy process for estimating remaining costs. The Legislature may wish to direct staff to work with the Legislative Analyst's Office, Department of Finance, CSM, and SCO on how to improve transparency in the payment of claims and estimation of the state's obligation.

## Child Care and Early Learning

### BACKGROUND

California provides subsidized child care for eligible families who meet specified criteria: (1) families whose incomes are below 70 percent of the state median income; (2) if parents are working or participating in an education or training program; and, (3) children are under the age of 13. The state subsidizes child care for several years, through the CalWORKs program and through non-CalWORKs child care, such as General Child Care and Alternative Payment programs. CalWORKs Stage 1 care is 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.

**Reimbursement rates differ between voucher-based and direct contract systems.** California has two child care delivery systems: one voucher-based; and the other through a direct-contract with the California Department of Education (CDE). Voucher-based care consists of CalWORKs Stages 1, 2, and 3, and non-CalWORKs Alternative Payment (AP) programs. Parents are offered vouchers to purchase care from licensed or license-exempt caregivers, such as friends or relatives who provide in-home care. Families can use these vouchers at any licensed child care provider in the state, and the value of child care vouchers is capped. The state will only pay up to the Regional Market Rate (RMR), which is a different amount in each county. Currently, the RMR is set to the 85<sup>th</sup> percentile of the RMR survey conducted in 2009, reduced by 10.11 percent, and then increased by 4.5 percent.<sup>1</sup> However, if a county’s ceiling is less than the ceiling provided before January 1, 2015 under the RMR survey, state law authorizes a hold-harmless provision, so that CDE must use the ceiling from the RMR survey conducted in 2005. 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.

In contrast, programs that contract directly with CDE are known as Title 5 programs, which must comply with Title 5 of the California Code of Regulations, and must meet additional requirements, such as development assessments for children, rating scales, and staff development. The Standard Reimbursement Rate (SRR) is the same (depending on the age of the child), no matter where in the state the program is located. Currently, the SRR is \$38.29.

<sup>1</sup> Effective October 2015, SB 97 (Budget and Fiscal Review), Chapter 11, Statutes of 2015, authorized an additional 4.5 percent increase to existing RMR rate, which was the 85<sup>th</sup> percentile of the RMR survey conducted in 2009, minus 10.11 percent. Education Code §8447 (b)(2).

**Budget actions.** Over the last two years, the budget and trailer bills<sup>2</sup> included investments that focus on quality enhancements, restoration and expansion of preschool access, increased reimbursement rates, and increased slots. Below is a table that summarizes child care and preschool investments in the Budget Act of 2015:

**Budget Act of 2015: Child Care and Preschool Investments Summary**

<b>2015-16 Child Care and Preschool Changes</b>			
<i>(In Millions)</i>			
<b>Change</b>	<b>Proposition 98</b>	<b>Other</b>	<b>Total</b>
<b>Reimbursement Rates</b>			
Increases the Standard Reimbursement Rate 5 percent starting July 1, 2015	\$38	\$23	\$61
Increases Regional Market Rate 4.5 percent starting October 1, 2015	—	44	44
Annualizes Regional Market Rate increase initiated January 1, 2015	—	34	34
Increases license-exempt rate from 60 percent to 65 percent of family child care home rates starting October 1, 2015	—	18	18
Provides 1.02 percent COLA to Standard Reimbursement Rate	6	8	14
Increases part-day State Preschool rate 1 percent starting July 1, 2015	6	—	6
Subtotals	(\$50)	(\$127)	(\$177)
<b>Slots</b>			
Provides 6,800 Alternative Payment Program slots starting July 1, 2015	—	\$53	\$53
Provides 7,030 full-day State Preschool slots starting January 1, 2016 <sup>a</sup>	\$31	3	34
Annualizes funding for 4,000 full-day State Preschool slots initiated June 15, 2015	15	19	33
Provides 2,500 part-day State Preschool slots with priority for children with disabilities starting July 1, 2015	12	—	12
Increases non-CalWORKs slots for statutory growth <sup>b</sup>	2	3	5
Subtotals	(\$60)	(\$78)	(\$138)
<b>Other</b>			
Makes CalWORKs child care caseload and average cost of care adjustments	—	\$116	\$116
Provides one-time infant and toddler quality activity block grant	—	24	24
Carries forward one-time funds for federally required quality activities	—	3	3
Shifts LEA full-day State Preschool "wrap" into Proposition 98	\$145	-145	—
Removes one-time funding for State Preschool facilities and quality activities	-35	—	-35
Subtotals	(\$110)	(\$2)	(\$108)
<b>Totals</b>	<b>\$220</b>	<b>\$203</b>	<b>\$423</b>

<sup>a</sup> Of these slots, 5,830 are for local educational agency (LEA) providers, with the remainder for non-LEA providers.  
<sup>b</sup> Applies 1.39 percent growth to Alternative Payment Program slots and 0.37 percent growth to all other non-CalWORKs child care programs.  
 COLA = cost-of-living adjustment.  
 Posted October 2015.

Source: Legislative Analyst’s Office 2015

<sup>2</sup> 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.

**GOVERNOR’S PROPOSAL**

The budget includes \$3.6 billion total funds (\$948 million federal funds; \$1.7 billion Proposition 98 General Fund; and \$998 million non-Proposition 98 General Fund) for child care and early education programs. For specific information by program, please see tables below.

**Child Care and Preschool Budget  
(Dollars in Millions)**

<b>Program</b>	<b>Governor’s Budget</b>
<b>CalWORKs Child Care</b>	
Stage 1	\$394
Stage 2	422
Stage 3	316
<b>Subtotal</b>	<b>\$1,132</b>
<b>Non-CalWORKs Child Care</b>	
General Child Care	\$450
Alternative Payment	255
Other	31
<b>Subtotal</b>	<b>\$736</b>
<b>Preschool-Age Programs</b>	
State Preschool	--
Transitional Kindergarten	--
Preschool Quality Rating Improvement System Grant	--
Proposed Block Grant	1,654
<b>Totals</b>	<b>\$3,600*</b>

\*\$3.6 million reflects the subtotals plus an additional \$79 million for support programs.

**Child Care and Preschool Subsidized Slots**

<b>Program</b>	<b>Description</b>	<b>2015 Budget Act</b>	<b>Proposed Slots for 2016-17</b>	<b>Percent Change</b>
<b>CalWORKs (based on estimated caseload)</b>				
Stage 1	Provides cash aid and services to eligible families. Begins when a participant enters CalWORKs.	44,154	42,995	-3%
Stage 2	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.	50,971	49,777	-2%
Stage 3	When a family expends time limit in Stage 2, and as long as family remains otherwise eligible.	35,845	36,335	1%
<b>Subtotals for CalWORKs child care</b>		<b>130,970</b>	<b>129,107</b>	<b>-1%</b>
<b>Non-CalWORKs (based on proposed number of slots to be funded)</b>				
General Child Care	State and federally funded care for low-income working families not affiliated with CalWORKs. Serves children from birth to 12 years old.	28,738	42,134	47%
Alternative Payment	State and federally funded care for low-income working families not affiliated with CalWORKs. Helps families arrange and make payment for services directly to child care provider, as selected by family.	32,852	29,344	-11%
Migrant Care	Serves children of agricultural workers.	3,060	3,064	0%
Care for Children with Severe Disabilities	Provides supervision, therapy, and parental counseling for eligible children and young adults until 21 years old.	105	105	0%
<b>Subtotals for non-CalWORKs care</b>		<b>64,755</b>	<b>74,647</b>	<b>15%</b>
<b>Preschool and TK programs</b>				
State Preschool	Part-day (PD) and full-day (FD) care for 3 and 4-year old children from low-income families.	98,956 PD 58,504 FD	0	-100%
Transitional Kindergarten	Eligible children are 5 years old between Sept. 2 and Dec. 2.	83,000	0	-100%
Early Ed. Block Grant	Restructures funding for above programs into a to-be-defined block grant.	0	251,409	100%
<b>Subtotals for Preschool/TK programs</b>		<b>240,460</b>	<b>251,409</b>	<b>5%</b>
<b>Total</b>		<b>436,185</b>	<b>455,163</b>	<b>4%</b>

Source: Legislative Analyst’s Office 2015

The budget also contains a funding restructure proposal for programs that serve pre-kindergarten aged children; child care trailer bill language; and additional program adjustments.

A major budget proposal is to consolidate Proposition 98 funding from the State Preschool Program (\$880 million), transitional kindergarten (TK) (\$725 million Proposition 98 General Fund), and the Preschool Quality Rating and Improvement System Grant (QRIS) (\$50 million Proposition 98 General Fund) to create a \$1.65 billion block grant, intended to benefit low-income and “at-risk” preschoolers. According to the Administration, the proposal would build on the tenets of the Local Control Funding Formula (LCFF) and distribute funding based on similar LCFF factors, such as population and need, to ensure funds are equitably distributed to schools with large populations of disadvantaged children. Also, the budget provides a hold-harmless provision, ensuring that no local education agency (LEA) will receive less funding under the block grant than under prior funding models. Of note, the proposal does not move funds currently supporting the wrap component of full-day State Preschool provided by non-LEAs into the block grant.

The budget also proposes trailer bill language that requires the Department of Education to develop a plan to transition contracted funding into vouchers over the next five years. Approximately two-thirds of California’s child care is voucher-based care, meaning a voucher is provided to a family who can then choose its own provider. It is envisioned that the move to voucher-based care, as administered by existing alternative payment agencies, will equip families with more access and choice to care, particularly for non-traditional hour care.

In addition, the budget includes the following adjustments:

- **Full-year implementation of 2015 Budget Act investments.** The budget reflects the following full-year costs of several investments, including: (1) an increase of 7,003 full-day State Preschool slots, beginning January 1, 2016; (2) a 4.5 percent increase to the RMR; and (3) a five-percent rate increase for license-exempt providers. The latter two began in October 1, 2015. The budget includes an increase of \$16.9 million non-Proposition 98 General Fund and \$30.9 million Proposition 98
- **Child Care and Development Funds.** The budget includes an increase of \$10.4 million federal funds, totaling \$593.2 million federal funds.
- **CalWORKs Child Care.** The budget includes an overall year-to-year increase of about \$18 million to fund changes in CalWORKs child care caseload and the type of care selected. Specifically, the budget includes \$422.3 million for Stage 2 (an increase of \$1.8 million non-Proposition 98 General Fund to reflect an increase cost per case); and, \$315.9 million for Stage 3 (an increase of \$33.4 million non-Proposition 98 General Fund to reflect an increase in the number of cases and cost per case).

**ISSUES TO CONSIDER**

**More development is required before further consideration of the Early Education Block Grant proposal.** The budget does not provide detail about the components of the block grant proposal, but the Administration has released plans to engage stakeholders in the coming weeks and intends to provide more information, reflecting stakeholder input, by the May Revision. In constructing a new block grant, the Legislature may wish to consider the following topics of discussion:

- **Understanding the goals.** What are the key objectives the Administration seeks to achieve in restructuring funding for programs that serve “at-risk” four-year-olds and young five-year-olds? Is this proposal informed by how other states administer funding for pre-kindergarten programs?
- **Defining eligibility criteria for students and families.** How will the Block Grant define “at-risk” children? What are the income eligibility requirements for families?
- **Establishing the program criteria.** What are the teacher/aide qualifications for a program that receives funding from this block grant? Are there specific class-size or teacher ratios for the classroom?
- **What happens to existing programs.** How will private child care providers be impacted by this proposal? For LEAs that currently operate a TK program, how will it transition to operate within a block grant funding structure? How does this proposal impact the LCFE funding model? What is the envisioned timeline of implementation?
- **The state’s current rate reimbursement structure poses challenges to transparency, quality, and efficiency.** Advocates argue that deficits during the Great Recession have weakened the infrastructure of the child care delivery system. In some instances, larger providers have absorbed some small and medium-sized providers – an indication that the SRR may not be sufficient for small and medium-sized providers to operate. Despite recent investments to the reimbursement rates for both voucher-based care (RMR) and for direct-contractors (SRR), providers indicate that they are still at-risk of closing. School districts and cities struggle between paying high rental costs and keeping a high-quality program afloat. Further, with increases to the minimum wage, the cost of paying the minimum wage may be too great for the provider.

Within this child care business context, four-year-olds have been considered the “balancer,” an age group that helps businesses break even, especially if the program also runs an infants and toddlers program, which is often more expensive care due to high-needs (e.g., formula, changing) and increased staffing ratios. If preschool provisions were shifted to LEAs, providers currently serving infants and toddlers could face challenges in making ends meet. This issue reflects the outdated nature of the current reimbursement rate system, in which providers often use their preschool contracts to make up for infant/toddler reimbursement rates that they say are unsustainable.

The Legislature may wish to consider whether the current reimbursement rate system is the most efficient and intuitive in delivering care. Recent budget investments continue to fund a child care structure that may benefit from broader considerations, including: (1) how and where is child care best delivered; (2) how to define “quality” measures that ensure developmentally-appropriate curriculums and environments for children and support for professionals; (3) how to improve access for families seeking care; and (4) how to improve the affordability of child care.

- **Re-thinking waiting lists.** If there are not enough slots for a program, families must contact contractors directly to request information about being placed on waiting lists. In the past, the state provided funding for a statewide Centralized Eligibility List (CEL), which consolidated waiting lists for subsidized child care programs and prioritized enrollment of eligible and needy children. Due to a budget deficit at the time, Senate Bill 87 (Budget and Fiscal Review Committee), Chapter 33, Statutes of 2011, eliminated funding for CEL. The Legislature may wish to consider the practical outputs of creating a mechanism that evaluates access to child care and provides real-time changes in the availability of slots.
- **Differing perspectives on child care.** Programs in the early care and education system generally have two key objectives: (1) to provide high-quality programs that support child development, and (2) to support parental work participation. The budget appears to distinguish the purpose of early learning, separate and apart, from child care, stating that “child care is to support the gainful employment of working families.” As more academic literature supports the social, cognitive, developmental, and economic benefits of investing in early childhood interventions, advocates and early education professionals have invested heavily in incorporating more developmentally appropriate curriculum, and supporting instructors in the child care system. The budget may identify child care as a work support, whereas the Early Education Block proposal, which serves specific age, “at-risk” learners, prepares them for the K-12 pipeline. The Legislature may wish to clarify how quality can be ensured in child care delivery, and how these differing perspectives on child care may influence the tenor of the proposal’s development.

## 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. Since the passage of Proposition 30 in 2012, the state has funded a multiyear investment plan starting 2013-14 for the public universities.

Since 2012-13, funding for UC has grown by \$691 million, and funding for CSU has grown by \$823 million. The budget continues that growth, proposing an additional \$125 million ongoing General Fund for UC and \$148 million ongoing General Fund for CSU in 2016-17. Additionally, the state has continued to fund robust financial aid programs, as discussed in the financial aid section, maintaining the Cal Grant entitlement even during the economic downturn, amounting to significant levels of indirect state support for institutions.

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 state constitution grants UC significant autonomy from legislative oversight, 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 priorities 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, 2014-15, 2015-16 budget proposals did not provide enrollment targets or enrollment funding, and instead gave the UC and CSU even greater flexibility in managing their resources to meet obligations, operate instructional programs most effectively, and avoid tuition and fee increases. However in the 2015-16 Budget Act, the budget included language to provide UC \$25 million in ongoing funding should UC increase resident undergraduate enrollment by 5,000 students by the 2016-17 academic year, when compared to the 2014-15 academic year. Additionally, budget bill language for CSU stipulates that CSU increase their enrollment by 10,400 full-time equivalent students.

### 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.

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 Board of 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, \$2.9 billion in 2014-15, \$3.3 billion in 2015-16, and \$3.4 billion in 2016-17 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)**

	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>
Personal Services	\$11,147	\$11,715	\$12,285
Operating Expenses and Equipment	\$16,709	\$17,161	\$17,490
<b>Total Expenditures</b>	<b>\$27,856</b>	<b>\$28,876</b>	<b>\$29,775</b>
<b>Positions</b>	<b>96,008</b>	<b>96,872</b>	<b>9,687</b>

**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. Joint doctoral degrees may also be awarded with the UC. 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.
- Support the primary functions of instruction, public services, and student services in the University.
- 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 budget. Of the amounts displayed in the table, \$2.76 billion in 2014-15, \$3.03 billion in 2015-16, and \$3.15 billion in 2016-17 are supported by the General Fund. The remainder of funding comes from tuition and fee revenue and various special and federal fund sources.

**California State University  
Budgeted Expenditures and Positions  
(Dollars in Millions)**

	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>
Personal Services	\$4,081	\$4,303	\$4,373
Operating Expenses and Equipment	4,968	4,836	4,953
<b>Total Expenditures</b>	<b>\$9,049</b>	<b>\$9,139</b>	<b>\$9,326</b>
<b>Positions</b>	<b>44,079</b>	<b>46,608</b>	<b>46,608</b>

## GOVERNOR’S PROPOSAL

**Multi-Year Funding Plan.** The Governor’s proposed budget includes a General Fund increase—\$125.4 million for the UC and \$148.3 million for CSU—to support the Administration’s fourth 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, and Hastings College of the Law over a four year period.

For UC, the budget assumes no systemwide tuition and fee increases for resident undergraduate students, except for a \$54 (five percent) increase in the Student Services Fee. The budget assumes UC will enroll 5,000 more resident undergraduates in 2016-17 and receive an associated \$25 million ongoing augmentation in 2015-16, pursuant to the 2015 Budget Act.

For CSU, the budget proposes (1) a \$125.4 million unallocated augmentation identical to UC's base increase, (2) an additional unallocated \$15 million associated with savings from changes to the Middle Class Scholarship program made in 2015-16, and (3) \$7.9 million for lease-revenue bond debt service. The Governor does not propose enrollment targets or enrollment growth funding and assumes no increase in tuition.

**Pay Down Debts and Liabilities.** The budget provides \$171 million one-time Proposition 2 funds to pay down the unfunded liability of the UC Retirement Plan. Consistent with the 2015 funding agreement, the UC Regents are expected to establish a retirement program that limits pensionable compensation consistent with the Public Employees' Pension Reform Act of 2014, no later than June 30, 2016.

**Deferred Maintenance.** The budget proposes \$35 million one-time General Fund each for deferred maintenance.

**Energy Projects.** The budget proposes \$25 million one-time cap-and-trade funds for energy projects for UC, and \$35 million for CSU.

## ISSUES TO CONSIDER

**The State's Long-Term Goals for Higher Education.** According to a recent PPIC report, in 2030, 38 percent of all jobs will depend on workers with at least a bachelor's degree, but only about 33 percent of workers will have one. As a result, California will have a shortage of 1.1 million workers holding a bachelor's degree. Improving college enrollment and completion will not only help California meet its workforce demands, but workers will also benefit from higher wages and less unemployment when compared to less educated workers. As the state continues to reinvest in higher education, the Legislature may wish to consider how these investments address current and long-term education and workforce needs of the state. In particular, the Legislature may wish to consider methods to close the workforce gap, and increase the number of bachelor degrees.

**Higher Education Pipeline.** The PPIC states that one way to increase the number of college graduates in California is to increase the share of high school graduates eligible for the UC and CSU. In order to do so, the state needs to ensure that students complete appropriate course work to be college ready. According to data from the California Department of Education, in 2013-14, just 42 percent of high school graduates completed the A-G sequence of courses required for CSU and UC admissions. While less than half of all high school graduates complete A-G courses, completion rates for underrepresented minorities fare even worse with just 31 percent of African American, 32 percent of Hispanic, and 27 percent of American Indian or Alaskan Native high school graduates completing A-G courses work.

**12<sup>th</sup> Grade Graduates Completing all Courses  
Required for UC and/or CSU Entrance**

<b>Race</b>	<b>Percentage of High School Graduates who Completed A-G Courses</b>
African American	31%
American Indian or Alaskan Native	27%
Asian	71%
Pacific Islander	35%
Filipino	58%
Hispanic	32%
White	49%
Two or More Races	49%
None Reported	33%
Total	42%

In a survey conducted by the PPIC in April 2015, Californians are keenly aware of the importance of higher education, and about nine in ten California parents hope their children will earn at least a bachelor's degree. But Californians are worried that educational inequities will make it difficult for many students to be ready for college. In addition to low high school A-G completion rates, more than 40 percent of incoming freshmen at CSU require remediation, even though they have completed the A-G sequence. The PPIC notes improving access and completion rates for underrepresented groups, including Latinos, African Americans, and students from low-income groups, is essential to closing the gap. In order to meet the growing demands of the state's economy, the Legislature may wish to consider strategies to increase the number of students eligible to attend UC and CSU through increased access to A-G courses and other college preparatory courses, and strengthen the pipeline from K-12 to UC.

**UC and CSU Enrollment.** Similar to previous budget proposals, the 2016-17 budget does not propose additional funding for UC and CSU for enrollment. Instead, the budget proposes unallocated increases, giving UC and CSU discretion on use of the funds. The 2015-16 budget recognizes the need for increased enrollment, and provided a \$25 million General Fund increase if UC increases resident enrollment by 5,000 undergraduate students during academic years 2015-16 and 2016-17. The 2015-16 Budget Act also states that as a part of the \$217 million General Fund augmentation to CSU, CSU is expected to increase resident enrollment by at least 10,400 students by the end of fall 2016 semester.

**UC Fall Headcount Enrollment**

	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Difference between 2015 and 2014</b>
Resident	166,254	168,624	167,959	-1,681
Nonresident	21,754	26,188	30,907	4,719

As shown above, resident enrollment at UC decreased by 1,681 in 2015 compared to 2014. UC attributes this decrease in enrollment to lower than anticipated yield rates. Additionally, timing of the state’s proposal occurred after the admission process was complete. Despite this, UC strongly shares the Legislature’s interest in providing increased access for Californians, and as noted in their adopted budget, UC is committed to taking the actions necessary to meet the State’s enrollment goal.

Moreover, UC also plans to enroll above the 5,000 students noted in the 2015 Budget Act, by continuing to grow by 2,500 California undergraduates in each of the following two years. By 2018-19 – the last year included in the plan – UC plans to enroll 10,000 more California resident undergraduates than it did in 2014-15.

At the time of this writing, CSU enrollment data for fall 2015 was not available. However, CSU is estimating 10,252 enrollment growth between 2014-15 and 2015-16. For the 2016-17 year, CSU is projecting 3,343 enrollment growth.

According to the LAO, the Administration’s discretionary funding 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 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. 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. The Legislature may wish to ask the Administration why they approved enrollment growth in the 2015-16 budget, but did not propose any growth in the 2016-17 budget.

**Denied Eligible Students.** The CSU reported that since the fall of 2010, between 22,000 and 31,000 eligible students each year have been denied admission due to lack of funding. This supply and demand imbalance is more profound at some CSU campuses. When campuses or specific programs receive more eligible applicants than they have resources for, impaction occurs and campuses or programs restrict enrollment. For 2015-16, all programs are impacted at CSU Fullerton, CSU Long Beach, San Diego State University, San Jose State University, and Cal Poly San Luis Obispo.

**Eligible Fall Undergraduate Applicants**

	2009	2010	2011	2012	2013	2014	2015
<b>Admitted</b>	193,928	173,562	178,615	194,564	212,152	212,538	216,755
<b>Not Admitted</b>	10,435	28,803	21,697	22,123	26,430	30,665	31,825

Despite providing additional funding for enrollment growth at the CSU, 31,825 eligible students were denied admission CSU. While the number of denied edibles in 2015 is 1,160 higher than 2014, the growth rate is smaller compared to previous years. The Legislature may wish to examine whether or additional enrollment growth funding impacts the denied eligible rate, and explore alternative methods to address the thousands of eligible students denied admission.

In the January 2016 draft report of the Chancellor's Task Force for a Sustainable Financial Model for the CSU, the taskforce recommends an admissions redirection program which would provide denied eligible students who find their preferred campus is at capacity, with options to attend another CSU campus. The task force recognizes that many students are place-bound and it may be difficult to attend another CSU campus. CSU functions as a regional system, providing education to eligible students in their general vicinity. The Legislature may wish to consider whether this is the most effect approach to addressing access issues, especially given the CSUs function as a regional system.

**Eligibility Study.** As the UC and CSU increase enrollment at their respective institutions, the Legislature may wish to consider whether or not they are meeting the Master Plan Higher Education goal of student access. The 2015 Budget Act included \$1 million General Fund to the Office of Planning and Research to conduct an eligibility study to determine if admission requirements at UC and CSU are consistent with the state's Master Plan. The study will report the proportion of students eligible for admission to each segment by race, gender, ethnicity, region, and income, and will include an analysis of the factors affecting eligibility for admission to UC and CSU for each of those groups.

The report shall also include a discussion of any adjustments the University of California and the California State University have made, or plan to make, to admissions policies in response to the findings of the study. OPR is required to submit a report to the Legislature by December 1, 2016 with their findings.

In considering the Administration's proposals, the Legislature may wish to consider the following questions:

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

# State Student Financial Aid

## BACKGROUND

The Cal Grant program is the primary financial aid program run directly by the state. Modified in 2000 to become an entitlement award, Cal Grants are guaranteed to students who graduated from high school beginning in 2000-01 and meet financial, academic, and general program eligibility requirements. Administered by the California Student Aid Commission (CSAC), Cal Grant programs include:

- *Cal Grant A* high school entitlement award provides tuition fee funding for the equivalent of four full-time years at qualifying postsecondary institutions to eligible lower and middle-income high school graduates who have at least a 3.0 grade point average (GPA) on a four-point scale and apply within one year of graduation.
- *Cal Grant B* high school entitlement award provides funds to eligible low-income high school graduates who have at least a 2.0 GPA on a four-point scale and apply within one year of graduation. The award provides up to \$1,656 for book and living expenses for the first year and each year following for up to four years (or equivalent of four full-time years). After the first year, the award also provides tuition fee funding at qualifying postsecondary institutions.
- *Community College Transfer Award* provides a Cal Grant A or B to eligible high school graduates who have a community college GPA of at least 2.4 on a four-point scale and transfer to a qualifying baccalaureate degree granting college or university.
- *Cal Grant Competitive Award Program* provides 25,750 Cal Grant A and B awards available to applicants who meet financial, academic, and general program eligibility requirements. Half of these awards are reserved for students enrolled at a community college and who met the September 2 application deadline.
- *Cal Grant C Program* provides funding for financially eligible lower-income students preparing for occupational or technical training. The authorized number of new awards is 7,761. For new and renewal recipients, the current tuition and fee award is up to \$2,462 and the allowance for training-related costs is \$547.

In 2015-16, the maximum award for Cal Grants A and B are equal to the mandatory systemwide tuition fees at the UC (\$12,240) and CSU (\$5,472), \$9,084 at independent non-profit institutions and WASC-accredited private for-profit institutions, and \$4,000 at all other private for-profit institutions. The 2012–13 Budget Act scheduled a reduction in the maximum award for these students from the 2013–14 level of \$9,084 to \$8,056 in 2014–15, but subsequent budgets postponed the reduction. The 2015-16 Budget Act postponed the reduction until the 2017-18 academic year.

**Cal Grant Program Awards/Funding  
(Dollars in Millions)**

	2014-15	2015-16 Estimated	2016-17 Projected
High School Entitlement Awards	\$237,526	\$255,904	\$273,062
CCC Transfer Entitlement Awards	\$28,910	\$26,562	\$25,712
Competitive Awards	\$42,991	\$50,627	\$56,170
Cal Grant C	\$9,407	\$7,446	\$6,664

**Cal Grant Spending  
(Dollars in Millions)**

	2014-15 Actual	2015-16 Estimated	2016-17 Projected	Change from 2015-16 Amount Percent	
<b>Total Spending</b>	<b>\$1,809</b>	<b>\$1,966</b>	<b>\$2,103</b>	<b>\$137</b>	<b>7%</b>
<b>By Segment:</b>					
University of California	824	887	943	56	6%
California State University	594	669	734	65	10%
Private nonprofit institutions	241	253	261	9	3%
California Community Colleges	122	137	146	9	7%
Private for-profit institutions	27	21	19	-2	-11%
<b>By Program:</b>					
High School Entitlement	1,457	1,595	1,711	116	7%
CCC Transfer Entitlement	221	209	204	-5	-2%
Competitive	123	157	184	27	17%
Cal Grant C	8	5	4	-1	-18%
<b>By Award Type:</b>					
Cal Grant A	1,037	1,115	1,178	63	6%
Cal Grant B	764	846	921	75	9%
Cal Grant C	8	5	4	-1	-18%
<b>By Renewal or New:</b>					
Renewal	1,247	1,365	1,480	115	8%
New	562	601	624	22	4%
<b>By Funding Source:</b>					
General Fund	1,425	1,443	1,276	-167	-12%
Federal Temporary Assistance for Needy Families (TANF)	377	521	826	305	58%
Student Loan Authority Fund	6	0	0	—	—
College Access Tax Credit Fund	0	2	2	—	—

**California Dream Act.** The Dream Act was implemented in 2013-14, and allows undocumented and nonresident documented students who meet AB 540 requirements to apply for and receive private scholarships administered by public universities, state-administered financial aid, university grants, community college fee waivers, and Cal Grants. The Dream Act application is similar to the process of filing a Free Application for Federal Student Aid (FAFSA). Applicants who meet the Cal Grant eligibility requirements (as discussed above) are offered a Cal Grant award. In 2014-15 and 2015-16, 7,852 and 8,211 new Dream Act students were awarded a Cal Grant, respectively.

**The Middle Class Scholarship Program.** The Middle Class Scholarship (MCS) program provides a scholarship to UC and CSU students with family incomes of up to \$150,000. The scholarship amount is limited to no more than 40 percent of the UC or CSU mandatory system-wide tuition and fees. In 2015-16, the maximum award amount increased from 14 percent to 20 percent of tuition at CSU (\$768 to \$1,092) and UC (\$1,710 to \$2,448). The individual award amount is determined after any other publicly-funded financial aid is received. The program will be phased in over four years, with full implementation in 2017-18. The program is funded from the General Fund.

The 2015-16 budget included SB 81 (Committee on Budget and Fiscal Review), Chapter 22, Statutes of 2015, trailer bill legislation, making modifications to the MCS. The program previously had no asset ceiling, and the trailer legislation establishes an asset ceiling of \$150,000. (The asset ceiling excludes primary residences and funds in retirement accounts.) Starting in 2015–16, students with household assets above the ceiling are ineligible to receive a MCS. With the \$150,000 asset ceiling in place for the 2015-16 year, 9,194 students were disqualified from the MCS program. In the 2014-15 year, 10,251 awardees had assets above \$150,000, but received an MCS award offer since the ceiling was not in effect. Starting in 2016–17, SB 81 also prohibits recipients from receiving a total amount of assistance under the program that exceeds the equivalent of four years (or, in some cases, five years) of full–time attendance.

Additionally, SB 81 requires both income and asset limitations for eligibility to be adjusted for inflation starting in 2016–17. To reflect savings from these changes, as well as lower –than – anticipated participation in the program, trailer legislation adjusts the statutory appropriations for the program down from \$152 million to \$82 million in 2015–16, from \$228 million to \$116 million in 2016–17, and from \$305 million to \$159 million thereafter.

**Middle Class Scholarship Awards/ Funding  
(Dollars in Millions)**

	2014-15	2015-16 (as of October 2015)
<b>Number</b>	83,154	49,098
<b>Amount</b>	\$55.2	\$46.4

**Board of Governor’s Fee Waiver.** The Board of Governors (BOG) Fee Waiver is available specifically for students to waive the per-unit enrollment fee (currently \$46) at any community college. The BOG Fee Waiver is available to California residents, or students who are exempt from non-resident fees under AB 540, and have financial need based on the Free Application for Federal Student Aid (FAFSA) or are receiving Temporary Assistance for Needy Families (TANF), Supplemental Security Income /State Supplementary Payment (SSI/SSP) or General Assistance, or fall under certain income standards. For the 2014-15 academic year, more than one million California community college students, and 66 percent of all units earned, received a BOG Fee Waiver, totaling more than \$818 million in financial aid.

**Full-Time Student Success Grant.** The 2015 Budget Act created a new grant program, the Full-Time Student Success Grant, which provides additional assistance to California Community College students who enroll in courses full-time. The budget provides \$39 million Proposition 98 General Fund to leverage the existing Cal Grant B program with supplemental grant funding and an additional \$3 million was provided to assist community colleges in implementing the new grant program. Students who receive Cal Grant B Access awards, described above, will receive an additional supplemental award to help pay for non-tuition costs.

For the fall of 2015, about 50,000 awards were awarded to students, totaling \$15 million in additional grants. This means that about 50,000 students received an additional \$300 per semester or \$200 per quarter to help pay for their total cost of attendance.

## GOVERNOR’S PROPOSAL

The budget proposes a decrease of \$48.5 million General Fund in 2015-16 and an increase of \$88.7 million General Fund in 2016-17 to reflect revised costs of the Cal Grant program. Additionally, the budget proposes \$304.6 million in General Fund savings for the program due to increased federal TANF reimbursements budgeted for 2016-17. Lastly, the budget proposes an increase of \$34 million General Fund in 2016-17 to continue implementation of the Middle Class Scholarship Program, pursuant to current law.

## ISSUES TO CONSIDER

**Interaction with Tuition Fees at UC and CSU.** Under current state policy, Cal Grant award amounts keep pace with tuition fees at UC and CSU. The number of Cal Grant recipients grew by 60 percent between 2007-08 and 2014-15, and costs have grown by 122 percent during that period. A large portion of the increase in Cal Grant spending is due to tuition increases in the UC and CSU systems. Tuition grew during this same period by 84 percent at UC and 97 percent at CSU. The budget assumes no tuition fee increases at UC and CSU in 2016-17, except for a five percent increase in UC’s Student Service Fee. (See the *Investing in Higher Education* chapter of this report). Should annual tuition fee increases in the future, the Legislature may want to explore ways to constrain the anticipated growth in associated Cal Grant program costs.

**Student Debt.** Students that attend California public colleges and universities have some of the lowest debt in the nation upon graduation. According to the Project on Student Debt, by The Institute on College Access and Success (TICAS), about 69 percent of students graduating in 2013 from public four-year institutions and private non-profit four-year institutions in the US had student loan debt, with an average of \$28,400 per borrower. At UC, about 55 percent of students graduated with student debt; with an average student loan debt of \$19,100. At CSU, about 48 percent of students graduated with student debt; an average student loan debt of \$15,700.

**Total Cost of Attendance.** The Cal Grant program's focus on tuition largely ignores the considerable living expenses that students face. The Legislative Analyst's Office (LAO) notes that living expenses such as food and housing, transportation and other personal expenses make up the majority of undergraduate student expenses. These costs are relatively high in California—about 20 percent higher than national averages, according to the LAO. These expenses are similar for students at community colleges, California State University and the University of California. The following chart illustrates the average costs of students living in an apartment off campus:

**California Higher Education  
Comparison of College Costs**

<b>2015-16 Student Budgets</b>	<b>UC Berkeley</b>	<b>CSU East Bay</b>	<b>Berkeley Community College</b>
Tuition and Fees	\$13,432	\$6,564	\$1,144
Housing and Food	9,764	12,267	11,160
Books and Supplies	1,240	1,500	1,710
Transportation/ Other Expenses	2,870	2,652	4,419
<b>Total Costs</b>	<b>\$27,306</b>	<b>\$22,983</b>	<b>\$18,433</b>
Tuition/ Fees Percent of Total Costs	49.19%	28.56%	6.21%

Despite this, Cal Grants remain largely focused on covering only the tuition and fee costs for students. Additionally, the BOG Fee waiver only covers tuition. The stipends associated with the Cal Grant B and the Cal Grant C programs provide some aid for living expenses, \$1,656 and \$547 annually respectively. However, these stipends do not come close to covering the cost of total expenses. California Community Colleges tuition is the lowest in the nation, however total college costs – including textbooks, transportation, and living costs – can exceed \$15,000 for a community college student living off-campus. As mentioned above, BOG Fee Waivers are widely available to help students with fee costs, but fees make up, at most, 10 percent of total college costs, and state and institutional grant aid for living expenses are limited. However, at other types of colleges, students' access awards may be supplemented with institutional grant

aid, or even additional state grant aid, but institutional grant aid at the CCCs is limited, and students often rely on the Cal Grant B access award and Full-Time Student Grant to help cover those costs.

To cover living expenses, many students must work part-time or even full-time jobs. This can have a detrimental effect on student outcomes. Research by the American Council on Education indicates that students working more than 15 hours per week are more likely to drop out of college than those working fewer than 15 hours.

The Legislature may wish to identify approaches to address total cost of attendance at the state's public higher education segments, evaluate the appropriate award amount for the Cal Grant B Access Award, and methods to increase the Cal Grant B Access Award amount.

**Many Low-income Students Not Served by the Cal Grant Program.** According to the National Bureau of Economic Research, low-income students are much less likely than higher income students to enroll in or complete college, and in recent decades, income gaps have grown. Cal Grants are a critical tool to help low-income students attend college and graduate. Cal Grants provide the possibility of upward mobility for low-income California students. CSAC states that 53 percent of Cal Grant recipients' parents have a high school degree or less than a high school degree; and the typical family income of a Cal Grant A and B recipient is \$27,248.

According to research done by TICAS, only 23 percent of very-low income students who apply for aid receive a Cal Grant. This is largely due to age restrictions on the Cal Grant entitlement program, which is reserved for recent high school graduates. In an effort to address this, the 2015 Budget Act increased the number of competitive Cal Grants that CSAC is authorized to award by 3,250, raising the total from 22,500 to 25,750. Until full implementation of the policy change, the cost of these new awards will increase as students renew their grants. The proposed budget includes \$14 million for these purposes. However, even after increasing the number of competitive Cal Grants, there are 14 eligible applicants for each available grant. The Legislature may wish to identify what the appropriate number of competitive Cal Grants awards should be. The Legislature may also wish to consider options to increase the number of low-income students who receive aid, aid amounts, and eligibility criteria.

**Low Paid Rate for California Dream Act Recipients.** As noted above, the Dream Act allows undocumented and nonresident documented students who meet AB 540 requirements to apply for and receive private scholarships funded through public universities, state-administered financial aid, university grants, community college fee waivers, and Cal Grants. The Dream Act is currently in its third year of its application and award process, below is a table illustrating award offers and payments by segment:

**Dream Act Program  
Awards and Recipients**

	2014-15			2015-16		
	Award Count	Paid Recipients	Paid Rate	Award Count	Paid Recipients	Paid Rate
CCC	3,825	2,104	55%	3,903	724	19%
UC	1,143	1,026	90%	1,188	640	54%
CSU	2,644	1,901	72%	2,844	1,008	35%
Private 4-Year	239	137	57%	264	60	23%
Total	7,851	5,167	66%	8,211	2,433	30%

As shown above, the pay rate for 2014-15 was 66 percent or 2,648 awards were not paid, and in 2015-16 the pay rate was 30 percent. CSAC is working to determine why students did not utilize their Cal Grant award. CSAC staff plans to monitor and communicate more closely with the Dream Act students and their self-reported college of attendance to increase the utilization rate in the 2015-16. The Legislature may wish to evaluate why UC and CSU have a higher paid rate than others segments to help, identify methods to increase paid rate, student participation and outreach.

# Community College Workforce Initiatives: Adult Education and Career Technical Education

## BACKGROUND

The California Community Colleges (CCC) 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 113 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 enact the Student Success Act.

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 to California's community colleges.
- To apportion state funds to districts and ensure prudent use of public resources.
- Improve district and campus programs through informational and technical services on a statewide basis.

The following table displays proposed 2016-17 expenditures and positions for the CCCs. Of the amounts displayed in the table, \$5.0 billion in 2014-15, \$5.4 billion in 2015-16, and \$5.4 billion in 2016-17 are supported by Proposition 98 General Fund. In addition, \$11.6 million in 2014-15, \$11.9 million in 2015-16, and \$18.6 million in 2016-17 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.

**California Community Colleges Budgeted Expenditures and Positions  
(Dollars in Millions)**

	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>
Personal Services	\$17	\$17	\$17
Operating Expenses and Equipment	\$5	\$7	\$8
Local Assistance	\$7,932	\$8,704	\$8,997
<b>Total Expenditures</b>	<b>\$7,954</b>	<b>\$8,728</b>	<b>\$9,022</b>
<b>Positions</b>	<b>162.7</b>	<b>168.7</b>	<b>168.7</b>

**Workforce Development**

According to a recent report by the Public Policy Institute of California, by 2025, California is likely to face a shortage of workers with some postsecondary education but less than a bachelor’s degree. In fact, the future gap among associate degree holders, those with one- or two-year technical certificates, and anyone who attended college but did not receive a credential, may be as high as 1.5 million. In addition to more traditional secondary and postsecondary education, the state, through community colleges, has also historically provided career technical education (CTE) for students to gain the basic knowledge and skills necessary to actively participate as citizens and to enter the workforce. The community college system is an entry point to postsecondary education for more than two million Californians, and is a potential gateway to the jobs of the future.

Community colleges provide CTE through their course offerings funded by Proposition 98 apportionments. The Legislative Analyst’s Office (LAO) estimates community colleges spend approximately \$1.7 billion in apportionment funds on CTE. Community colleges also receive categorical funds to support CTE efforts in nursing, apprenticeship and an economic development program, as well as CTE grant programs. Workforce programs also receive federal funds under federal workforce and education initiatives. As the state explores ways to improve the provision of services and outcomes for students, services and funding for CTE have been in flux for several years.

According to an inventory of CTE courses published in 2012 by the Institute for Higher Education Leadership and Policy at Sacramento State University, community colleges collectively offered about 8,000 CTE certificate programs and 4,500 associate degree programs. The Division of Workforce and Economic Development within the Chancellor's Office provides support to, and manages grants for, CTE programs across the state. The division manages other sources of CTE funding aside from apportionment funding, including the following:

**Economic and Workforce Development Program.** This categorical grant program funds the development of programs that address regional workforce needs and supports regional centers, hubs, or advisory bodies, among other things. The Chancellor's Office has recently used this funding to hire statewide and regional experts in specific industries to help improve and coordinate programs to benefit local economies. This program received \$23 million Proposition 98 Funds in 2015-16. For 2016-17, the Governor proposes level funding for these activities. In addition, the budget includes a \$200 million Proposition 98 increase in this categorical for a new CTE initiative (described under Governor's Proposal).

**Career Technical Education Pathways Initiative.** The purpose of this categorical program is to bring together community colleges, K–12 school districts, employers, organized labor and community partners to strengthen the connection between school and work. The California Community Colleges Chancellor's Office and the California Department of Education award initiative grants to both community colleges and K–12 schools and districts that place a high priority on CTE. The 2015 Budget Act provided \$48 million in 2014-15 Proposition 98 funding for the initiative and extended the program for one year through July 1, 2016. For 2016-17, the Governor proposes the same level of funding of \$48 million Proposition 98 funds and also makes the program permanent.

**Carl D. Perkins Career Technical Education Program.** The Carl D. Perkins Career Technical Education program provides \$113 million in ongoing federal funding for CTE programs, with half going to the K-12 system and half going to community colleges. Of these funds, 85 percent goes directly to LEAs and community colleges to be used for CTE purposes, including curriculum, professional development, and purchasing equipment and supplies. The remaining 15 percent is provided to the CDE and the Community College Chancellor's Office for administration of various CTE programs.

**Nursing Program Support.** This is a categorical program that provides grants to colleges to increase nursing program enrollment and completion rates. The grants are distributed on a two-year basis. Funding in 2015-16 was \$13.4 million Proposition 98 General Fund and the same amount is proposed for 2016-17.

**Apprenticeship.** This is a categorical program that allows apprentices in industries such as firefighting and building trades to receive on-the-job training through an employer and classroom instruction through K-12 or community college partners. State funding is used for industry-approved primary and supplemental instruction. The 2013 Budget Act moved the apprenticeship program previously administered by the Department of Education into the community college budget. Thus, there are now two apprenticeship categorical programs administered by the Chancellor's Office: one originally administered by CCC and one transferred from CDE. Funding in 2015-16 was \$31 million Proposition 98 General Fund for the community college program and \$20 million Proposition 98 General Fund for the K-12 program; funding levels in 2016-17 are proposed to be \$32 million and \$22 million, respectively.

The 2015-16 budget increased funding for established apprenticeship programs by \$14 million Proposition 98 General Fund, and provided \$15 million Proposition 98 General Fund to establish new apprenticeship programs in high-demand occupations, such as health care fields. The

Legislature approved trailer bill language to establish the new apprenticeship programs and modified language to include local educational agencies, as well as community colleges.

**Doing What Matters for Jobs and the Economy.** In an effort to better align CTE and workforce development programs with regional employer needs, the Chancellor's Office launched an initiative requiring regional collaboration between colleges and industry. Colleges are working to ensure their programs have similar curricula so that employers have a better sense of what skills a graduate has as he or she leaves college. Regions also are required to select from specific industry sectors to focus programs on regional workforce needs. The 11 economic regions are working to develop plans to better support programs for the sectors they have selected. Among the sectors are:

- Advanced Manufacturing
- Advanced Transportation and Renewables
- Agriculture, Water and Environmental Technologies
- Energy Efficiency and Utilities
- Global Trade and Logistics
- Health
- Information and Communication Technologies/Digital Media
- Life Sciences/Biotech
- Retail/Hospitality/Tourism
- Small Business

On November 17, 2014, the California Community Colleges Board of Governors commissioned the Task Force on Workforce, Job Creation and a Strong Economy to consider strategies and recommend policies and practices on how the community college system can improve workforce training. The task force was comprised of representatives from community college faculty, staff, administration, trustees and students, the employer community, labor, public agencies involved in workforce training and economic development, K-12 education policy and community-based organizations. The work of the task force involved regional college conversations, town hall meetings, and task force meetings. In the Fall of 2015, the task force released a report with 25 recommendations on student success, career pathways, workforce data and outcomes, curriculum, CTE faculty, regional coordination, and funding. Implementation of these recommendations requires statutory, regulatory and administrative changes. Of the recommendations, the Chancellor's Office's recommendations that require legislative or budget action for implementation are shown in the following table:

**Task Force on Workforce, Job Creation and a Strong Economy  
Legislative and Budget Recommendations**

<b>Recommendation</b>	<b>Action</b>
<p><b>Student Success</b></p> <ul style="list-style-type: none"> <li>Support efforts to increase financial support under the Cal Grant C program for community college CTE students.</li> </ul>	Legislative
<p><b>Workforce and Data Outcomes</b></p> <ul style="list-style-type: none"> <li>Develop, streamline, and align common outcome metrics for all state-funded CTE programs and ensure that they are compatible with federal reporting requirements.</li> <li>Require the sharing of employment/wage outcomes and third party licenses/certification data across government entities.</li> </ul>	Legislative
<p><b>Curriculum</b></p> <ul style="list-style-type: none"> <li>Revise existing policies regarding the use of a state required audit fee to provide colleges with the necessary flexibility to allow auditing of credit courses previously completed as an option for students to refresh their skills and knowledge</li> </ul>	Legislative
<p><b>Regional Coordination</b></p> <ul style="list-style-type: none"> <li>Support college collaborations to leverage multiple state and federal CTE and workforce funding streams to build capacity to meet regional needs and mitigate the risk associated with new program start-up.</li> </ul>	Budget
<p><b>Funding</b></p> <ul style="list-style-type: none"> <li>Create a sustained, public outreach campaign to industry, high school students, counselors, parents, faculty, staff, and the community at large to promote career development and attainment and the value of career technical education.</li> <li>Target funding to offset the high cost of CTE programs and other courses that lead to CTE programs.</li> <li>Provide additional fiscal incentives to support high-value outcomes and continuously evaluate the results to determine effectiveness.</li> <li>Develop and support a sustainable and adequate equipment and facilities funding stream.</li> <li>Create a predictable, targeted, and sustained funding stream that leverages multiple local, state, and federal CTE and workforce funds to support an infrastructure for collaboration at the state, regional and local levels; establish regional funding of program start-up and innovation; and develop other coordination activities.</li> <li>Evaluate the impact of student fees for disposable and consumable materials on CTE programs and students. If warranted, explore options for funding support that does not limit student access, such as covering the cost of fees under a BOG waiver.</li> <li>Provide flexibility and funding for new and modernized CTE facilities.</li> </ul>	Budget

**GOVERNOR'S PROPOSAL**

The Governor's budget contains two proposals designed to enhance the workforce programs at the community colleges. The budget:

- **Creates New Workforce Program, Makes Another Permanent.** The budget includes \$200 million in new ongoing funding to implement recommendations of the Board of Governors Task Force on Workforce, Job Creation, and a Strong Economy. The new "Strong Workforce Program" would require community colleges to collaborate with education, business, labor, and civic groups to develop regional plans for career technical education (CTE). The regions would be based on existing planning boundaries for the federal Workforce Innovation and Opportunity Act (WIOA).
- **Extends Career Technical Education Pathways Initiative.** The budget also includes \$48 million in ongoing funding to support the CTE Pathways Program. Over the last 11 years, this program has supported regional collaboration among schools, community colleges, and local businesses to improve career pathways and linkages. The state had scheduled to sunset the program at the end of 2014–15 but extended it through 2015–16 using one-time funding. The Governor proposes to make the program permanent and align future CTE Pathway funding with the regional plans developed under the Strong Workforce Program. The Pathway program would continue to have separate categorical requirements.

**Other Community College Budget Proposals**

- **Apportionments.** The budget provides \$115 million Proposition 98 General Fund for two percent enrollment growth and \$29 million for a 0.47 percent cost-of-living adjustment (COLA).
- **Basic Skills Initiative.** The budget proposes \$30 million ongoing Proposition 98 General Fund for the Basic Skills Initiative to implement practices that increase student mobility to college-level courses.
- **Institutional Effectiveness Initiative.** The budget proposes \$10 million ongoing Proposition 98 General Fund for the Institutional Effectiveness Initiative, bringing total funding to \$27.5 million. This includes \$8 million for workshops and training and \$2 million for technical assistance to local community colleges and districts.
- **Zero-Textbook-Cost Degrees.** The budget provides \$5 million ongoing Proposition 98 General Fund for campuses to develop "zero-textbook-cost" degree and certificate programs using open educational resources.
- **Telecommunications and Technology Infrastructure Program.** The budget proposes \$3 million ongoing Proposition 98 General Fund to improve systemwide data security.
- **Cost-of-Living Adjustments for Categorical Program.** The budget provides \$1.3 million Proposition 98 General Fund for a 0.47 percent COLA for Extended Opportunity Programs

and Services, Disabled Student Programs and Services, and the CalWORKs Program. The Administration also provides \$1.8 million Proposition 98 to raise the apprenticeship funding rate to the highest noncredit rate.

- **Deferred Maintenance.** The budget proposes \$289 million one-time Proposition 98 increase for deferred maintenance, instructional equipment, and specified water conservation projects. Community colleges will not need to provide matching funds for deferred maintenance in 2016-17.
- **Mandate Debts.** The budget provides \$76.3 million one-time Proposition 98 General Fund increase to pay-down outstanding mandate claims. These payments will further reduce outstanding mandate claims and open up one-time resources to address various one-time needs, such as campus security, technology and professional development.
- **Innovation Awards.** The budget proposes \$25 million Proposition 98 General Fund for innovation awards focusing on technology, transfer pathways and successful transition from higher education to the workforce.

## ISSUES TO CONSIDER

California's Employment Development Department (EDD) estimates that by 2020, employment in the state will have grown by 16 percent, which amounts to about 2.6 million new jobs. According to the PPIC, more than half of these new jobs will be in four industries that already constitute a third of the state's jobs: health care and social assistance; accommodation and food services; professional, scientific, and technical services; and retail trade. Overall, most industries will grow, some faster than others; some manufacturing sectors will shrink.

Additionally, the PPIC notes that over the next decade, the share of new jobs requiring some college will equal the share requiring a bachelor's degree (each is estimated to be 32 percent of the total). Roughly two-thirds of the share of new jobs for "some college" workers will require less than an associate degree. As the Legislature evaluates the Governor's workforce proposals over the coming months, it may wish to consider whether or not the proposals will help close this workforce gap, as well as evaluate other funding options.

**Funding CTE Programs.** According to the Task Force on Workforce, Job Creation and a Strong Economy, when compared to non-CTE courses, CTE courses are often more costly due to requirements for lower student-instructor ratios, additional support staff, and specialized facilities, equipment, and/or materials. This higher cost creates a disincentive for offering CTE courses relative to non-CTE courses. Additionally, the task force states that during budgetary shortfalls, there is a greater incentive to cut these programs. The Governor proposes \$200 million Proposition 98 General Fund to support the Strong Workforce Program, which will enable community colleges to expand access to additional CTE courses and programs and to implement a regional accountability structure that is aligned to task force recommendations. Additionally, the Governor proposes to distribute the new workforce program funding to community college districts based on their WIOA regions; however, details regarding the allocation formula are not yet available. The Legislature may wish to consider what the appropriate allocation formula should be in order to ensure that these programs receive adequate funding.

**Supplemental Funding.** According to EdInsights, formerly, (the Institute for Higher Education Leadership and Policy [IHELP]), fourteen of twenty states studied in 2013 have adopted or implemented some form of CTE performance-based funding. These states use completion of certificate and degree as an outcome measure, and allocate funding to CTE programs that demonstrate they are preparing students for careers, or provide additional funding based on job placement rates or wage gain. However, a poorly designed performance-based funding formula also entails some risks. For example, using completions as an outcome measure could create pressure to lower standards in order to increase graduation rates and obtain additional funding.

Additionally, thirteen of the twenty states studied, have adopted or implemented some form of differential funding, which takes into account that some courses and programs have higher costs than general education courses. The Task Force on Workforce, Job Creation and a Strong Economy suggests this could be in a form of a block grant or categorical program that targets high cost programs. According to the task force, supplemental funding would allow colleges to move away from grant-based funding and instead provide a reliable funding source. This change could create incentives for better outcomes on job placement, and wage increases.

**Cal Grant C Program.** As discussed in the State Student Financial Aid section, the California Student Aid Commission (CSAC) administers the Cal Grant program, which provides grants to financially needy students to attend college. Cal Grant C awards assist with tuition and training costs at occupational or vocational programs, and may be used for institutional fees, charges, and other costs, including tuition, plus training-related costs, such as special clothing, local transportation, required tools, equipment, supplies, books and living expenses. Current law establishes the total number of Cal Grant C awards as the numbers awarded in 2000-01 fiscal year (7,761) with the maximum award amount and total amount of funding being determined by the annual budget act.

Cal Grant C funding is available for up to two years, depending on the length of the program. To qualify, a student must enroll in a program that is at least four months long at a community college, an independent college, or a vocational school. In 2013-14, the maximum annual award was \$547 for training-related costs and up to \$2,462 more for tuition and fees for attendance at other than a CCC.

According to a 2013-14 CSAC report, almost 82 percent of Cal Grant C awardees are independent students. About 62 percent earned less than \$18,000 annually, and more than 85 percent earned less than \$30,000 annually. Almost half are over the age of 30. CSAC reports 15,159 Cal Grant C awards in 2013-14 with 12,800 attending a CCC, two at UC campuses, 36 attend another public institution, 105 attend an independent college, and 1,483 attend private for profit institution. Although the vast majority of students who receive the Cal Grant C enroll in community college programs, almost two-thirds of the total funds awarded are paid to students who enroll in vocational for profit programs.

Any student receiving a Cal Grant C at the community colleges is automatically eligible for a Board of Governor's fee waiver. Thus, Cal Grant C awards for CCC students include only the \$547 for costs other than tuition and fees. Although SB 1028 (Jackson), Chapter 692, statutes of

2014, expanded the allowable use of the Cal Grant C to include living expenses, the CCC reported that the Department of Finance and the CSAC do not believe the expanded language extends to community college students. The Legislature may wish to consider whether the state should increase the Cal Grant C tuition/fees or access costs for all recipients, including those who attend a public community college. The Legislature may also wish to consider whether increasing the overall award amount would have the effect of incentivizing recruitment of Grant C recipient students by private and/or for-profit institutions.

**Fragmented System.** The LAO states that the Governor’s focus on better regional alignment of workforce education is a laudable goal but states that the approach further fragments an already fragmented system. In 2015–16, the state budgeted \$6 billion for more than 30 workforce programs administered across nine state agencies. Of these amounts, \$2.6 billion and nine programs were administered or co-administered by community colleges. To comply with the requirements of these existing workforce programs, community colleges already participate in numerous local and regional consortia of education, business, labor, and civic groups. Each of these programs also has unique service and accountability requirements. LAO argues that the new workforce program the Governor proposes would add another set of rules to the current mix and that continuing the otherwise expiring CTE Pathways program would retain a separate set of rules permanently. Rather than adding to the complexity and fragmentation of the state’s workforce system, the LAO recommends the Legislature remain focused on the overarching vision of moving toward a more coherent and integrated system. The Legislature may wish to consider consolidating and streamlining existing workforce programs rather than creating new ones.

# SUBCOMMITTEE No. 2

## RESOURCES, ENVIRONMENTAL PROTECTION, ENERGY and TRANSPORTATION

### **Resources**

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# Managing the State's Beverage Container Recycling Programs

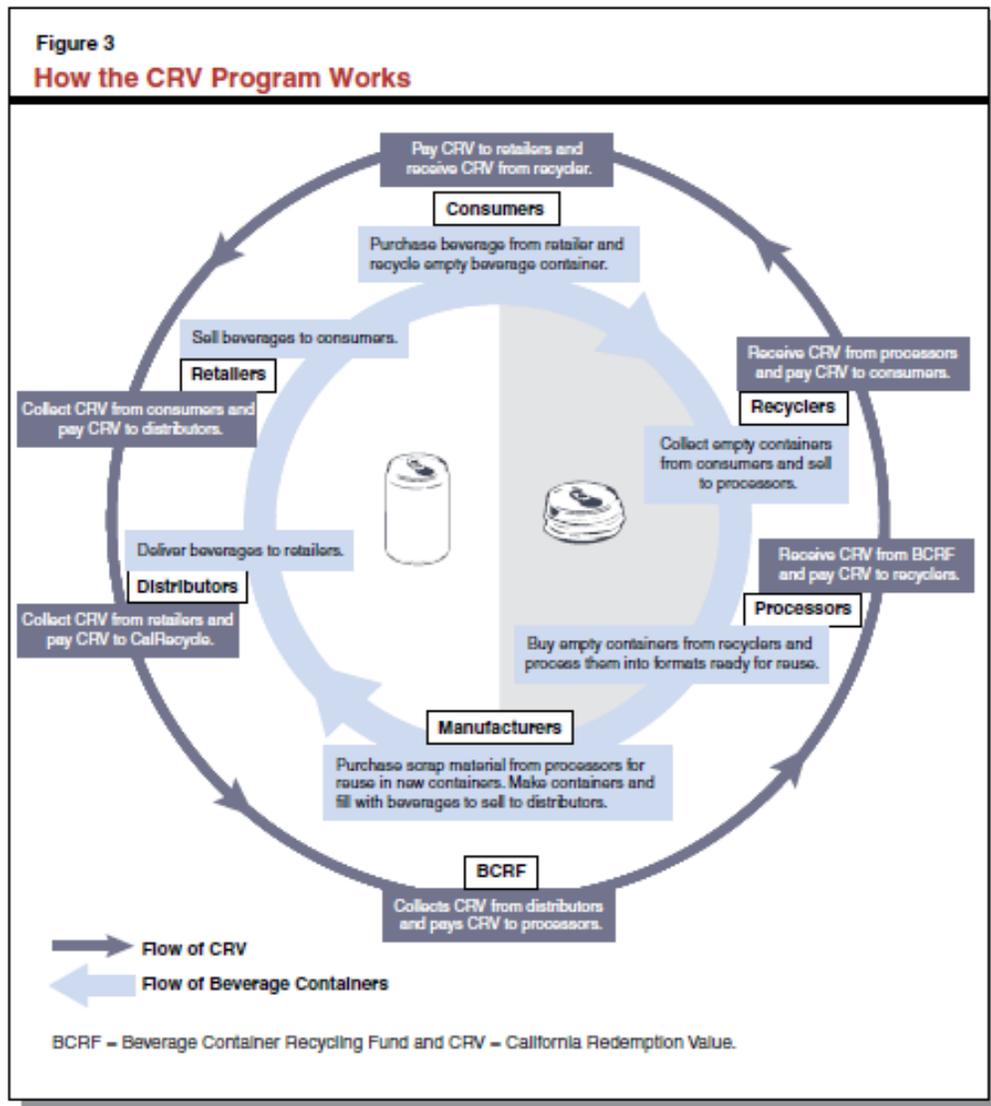
## BACKGROUND

The Department of Resources, Recycling and Recovery (CalRecycle) oversees and provides guidelines for most household and commercial waste, including the garbage picked up outside homes and businesses, recycling and compost. CalRecycle's mission is to restore, protect, and manage the state's natural, historical, and cultural resources for current and future generations using creative approaches and solutions based on science, collaboration, and respect for all the communities and interests involved. The largest single program at CalRecycle is the Beverage Container Recycling Program (BCRP).

The BCRP was established almost 30 years ago with the enactment of AB 2020 (Margolin), Chapter 624, Statutes of 1986. The purpose of the program is to be a self-funded program that encourages consumers to recycle certain beverage containers. The program accomplishes this goal by first requiring consumers to pay a deposit for each eligible container purchased. Then the program guarantees consumers repayment of that deposit—the California Redemption Value, or “CRV”—for each eligible container returned to a certified recycler. Statute includes two main goals for the program: (1) reducing litter and (2) achieving a recycling rate of 80 percent for eligible containers.

Despite paying the CRV deposit, not all consumers recycle their CRV-eligible containers. In 2013–14, for example, the Beverage Container Recycling Fund (BCRF) received roughly \$1.2 billion in deposits, but only about \$1 billion—over 80 percent—was spent on redemption payments. The BCRF retains unredeemed deposits, and state law requires that much of the unredeemed CRV be spent on specified recycling-related programs. These supplemental programs are not directly involved in the exchange of CRV, but they are intended to help achieve the programmatic goals of increased recycling and reduced litter. There are currently ten supplemental programs funded from the BCRF (including program administration). Such programs include subsidizing glass and plastic recycling, encouraging supermarket recycling collection sites, and providing grants for market development and other recycling-related activities. CalRecycle estimates that a total of \$279 million will be spent on supplemental programs in 2015–16. The figure below describes how the CRV works.

How the California Redemption Value (CRV) Recycling Program Works



Source: Legislative Analyst’s Office 2015

**Quarterly Report on the BCRP.** CalRecycle is required to report quarterly on the status of the BCRP in order to review the adequacy of resources in the Beverage Container Recycling Fund for purposes of making payments specified in Public Resources Code (PRC) Section 14581 and the processing fee offsets specified in PRC Section 14575. This statutorily-required report provides updates on the status of all five funds in the Beverage Container Recycling Program. This report also provides projections for sales, recycling volumes (returns), processing payments, processing fees, and processing fee offsets, by material type, and handling fees. Finally, this report provides an explanation of significant changes between the current projections and the projections presented in the January 2015 report.

According to the most recent report, a combination of factors has imposed a strain on the Beverage Container Recycling Fund, resulting in an ongoing structural deficit. These factors include statutorily-prescribed payments established when the fund was running large surpluses, fraudulent activity, and ironically, the success of the program itself. In 2008-09, the recycling rate rose to 78 percent. Since then, the recycling rate has continued to increase. The current recycling rate is about 80 percent. Until now, the gap between expenditures and revenues has been temporarily bridged through repayments of loans, particularly to the General Fund, made from the Fund when it was operating at a surplus. The final loan repayment, amounting to \$82.3 million, was paid in full at the end of 2014-15.

**Update from the Most Recent Quarterly Report.** According to CalRecycle, the BCRP is currently operating with an approximately \$100 million annual structural deficit as a result of the combination of historically high recycling rates, mandated program payments and general fund loans. This figure can fluctuate as much as tens of millions of dollars from quarter-to-quarter as a result of economic shifts and other factors (including scrap value rates). The structural deficit means that program expenditures exceed program revenues under the current mandated expenditure and revenue structure. Potential program reforms will be required to address the structural deficit of the Recycling Fund and ensure the integrity and long-term viability of the BCRP.

In order to address the structural deficit, CalRecycle implemented several program reforms, including reduced daily load limits for redemption at recycling centers, increased monitoring of the importation of out-of-state beverage containers, and elimination of the commingled rate at buyback centers. This last reform allowed for slightly lower per-pound refund rates for loads containing a combination of CRV and non-CRV material. However, actions taken thus far have secured only partial success; while the gap is smaller, the amount of money coming into the BCRF is still insufficient to cover the amount being paid out. In order to eliminate the structural deficit and achieve a secure financial future for the fund and the programs it supports, further measures will be necessary.

**2014 State Auditor Report and Recommendations.** A recent audit by the Bureau of State Audits (BSA), released in November 2014, confirmed both the positive impact of the first round of reforms and the need for more. The audit confirmed the BCRF structural deficit, then approximately \$100 million, and recognized that changes such as reducing or eliminating administrative fees for beverage distributors, enacting changes to mandatory payments such as those for curbside programs or quality incentives to beverage program participants, or reducing or eliminating processing fee offsets, could improve the program's financial condition. The audit shows a decline in the projected average structural deficit, from \$56 million in January 2015 to \$27.9 million in 2014-15 through 2017-18, based on lower payouts, potentially stemming from the recent reforms, as well as higher revenues as beverage sales have increased with an improving economy.

The report made a series of recommendations, most of which the department has embraced. To ensure that it can demonstrate that its fraud prevention efforts are maximizing financial recoveries for the beverage program, BSA recommended CalRecycle modify and annually update its fraud management plan to include the following:

- Finalize a process to analyze the data the Department Food and Agriculture provided on out-of-state containers and act on the results to identify and prosecute those committing fraud.
- Develop fraud estimates—by type of fraudulent activity—that quantify the potential financial losses to the beverage program and the methodology CalRecycle used to develop these estimates.
- Identify the amount of actual fraud in the prior year by type of fraudulent activity, such as the financial losses resulting from the redemption of out-of-state beverage containers or the falsification of reports used to substantiate program payments.
- Identify the amount actually recovered for the beverage program in the form of cash for restitution and penalties resulting from fraud.
- Contract with the Board of Equalization (BOE) to determine the feasibility and cost of transferring its revenue collection duties and audit reviews to them.
- Should CalRecycle find that it is feasible and cost-effective, pursue legislative changes that enable the BOE to collect revenues for the beverage program at the point of sale and remit the money to the beverage fund.

**Legislative Analyst’s Office Review.** In 2015, the Legislative Analyst’s Office (LAO) recently conducted a thorough review of the BCRP and determined that not only is the shortfall accurate, certain offsets place additional costs on the program and the effectiveness of some of the supplemental programs are unclear. The LAO review found the following:

**High Recycling Rates and Spending on Supplemental Programs Create BCRF Shortfall.** The BCRF has operated under an annual structural deficit averaging about \$90 million since 2008-09. According to CalRecycle estimates, the fund is currently forecast to have an operating deficit of about \$60 million in 2015–16 and run an average deficit of \$56 million from 2014-15 to 2017-18, absent any changes made to reduce expenditures or increase revenues. This deficit is largely due to increased recycling rates in recent years, which have resulted in a greater share of BCRF revenue being paid out for CRV. Moreover, some supplemental programs are paid on a per container basis, and therefore these expenditures increase as the number of containers redeemed increases. The combined effects of higher recycling rates—more spending on CRV payments and certain supplemental program expenditures—make it much more difficult for the BCRF to operate with a structural balance.

**Beverage Container Recycling Fund Expenditures**

<b>Expenditures</b>	<b>2015-16 Projection</b>
Revenues (California Redemption Payments)	\$1,036.5
<b>Supplemental Program Expenditures</b>	
Processing fee offsets	75.4
Handling fees	55.3
CalRecycle administration	50.0
Administrative fees	44.7
Curbside supplemental payments	15.0
Payments to local governments	10.5
Plastic Market Development Payments	10.0
Quality Incentive Payments	10.0
Local Conservation Corps grants	6.4
Beverage Container Recycling Competitive Grants	1.5
<b>Total Expenditures</b>	<b>\$1,315.3</b>
<b>Deficit</b>	<b>(\$278.8)</b>

Source: Legislative Analyst's Office 2015

For the last several years, the fund balance that accumulated when recycling rates were lower was able to support this expenditure level. However, the balance is being depleted further each year, and programmatic changes will need to be made in the next few years in order to keep the fund solvent and avoid statutorily required automatic funding cuts (referred to as “proportional reductions”). Acting sooner would provide the Legislature a greater number of options to address the deficit and allow for more flexibility when implementing any changes.

**Offsets Are Major Cost to BCRF and Do Not Clearly Support Goals.** The state subsidizes recycling by making “processing payments” from the BCRF to recyclers and processors. Processing payments are intended to cover the difference between a container’s scrap value and the cost of recycling it (including a reasonable rate of return). These payments are funded from two sources: (1) “processing fees” paid by beverage manufacturers and (2) the BCRF supplemental program, referred to as “processing fee offsets,” which reduces the amount of processing fees that manufacturers must pay. Processing fee offsets—the amount of processing payments covered by the BCRF—are projected to be \$75 million in 2015–16.

It is unclear how current processing fee offsets provided to manufacturers incentivize increased recycling. Additionally, providing offsets does not require manufacturers to consider the lifecycle costs of the materials that they use in their products. By reducing the amount of processing fees, the offsets effectively subsidize materials that are relatively more expensive to recycle.

**Effectiveness of Some Supplemental Programs Unclear.** While supplemental programs might have merit, we find that many of the programs have not been evaluated for their effectiveness at improving recycling. This lack of evaluation makes it difficult to compare the relative cost-effectiveness of supplemental programs and to determine how they help to achieve program goals of increasing recycling and reducing litter. This information is critical in determining the best use of limited program dollars. In addition, the existing structure of “handling fee” payments currently made to certain recyclers does not maximize convenience for many consumers, and may raise convenience-zone recycler costs, resulting in higher handling fee payments from the BCRF. Finally, the department has not evaluated whether administrative fees—funds that beverage container distributors, processors, and recyclers receive to cover their administrative costs to participate in the BCRP—accurately reflect costs for these program participants.

**2014 Proposal—Phase 2 Reform.** In January 2014, the budget proposed ten programmatic changes that were expected to result in a net increase to the BCRF annual fund balance of \$72.3 million in 2014-15, growing to \$127 million when fully implemented in 2016-17. The changes would have both raised revenue and decreased overall program expenditures, while at the same time modestly increasing specific expenditures for fraud prevention, data collection, and expanded grant programs. The Administration projected that these changes would eliminate the program’s structural deficit once fully implemented, and avoid the need to implement proportional reductions.

**2014 Budget and Trailer Bill Actions.** The budget subcommittees did not approve trailer bill language and the budget proposals that would have provided the second phase of the BCRF reform. Instead, the Legislature approved trailer bill language to remove the Local Conservation Corps (LCC) from the statutory provisions of the program funding and diversified the LCC funding similar to that proposed by the Governor under the program reform proposal.

The budget also included several positions to increase audit coverage of beverage manufacturers and distributors to better protect the integrity of the BCRF. The emphasis was on collecting revenues owed to CalRecycle and mitigating risk to the fund.

**2015 Legislative Oversight and Actions.** The Legislature took action in the 2015 budget to make additional changes to the BCRP, specifically to address issues raised by the Legislature and BSA related to audits and compliance. With these actions, the Legislature can more confidently address the structural deficit as described by the department. These actions included:

- **Targeted Activities to Improve Program Integrity.** \$357,000 (BCRF) and three positions, and \$717,000 (BCRF penalty account) and seven two-year, limited-term positions, to implement targeted activities to enhance program integrity, reduce expenditures, and mitigate potential program funding shortfalls. The budget converted eight existing limited-term positions to permanent for ongoing program certification workload.
- **Processor Oversight Activities.** \$933,000 and ten two-year limited-term positions to establish a pilot program with dedicated on-site investigation resources at certified processor facilities. These positions will create a new pilot program to expand current fraud investigation activities on recyclers to processing facilities.

- **Rigid Plastic Packaging Container Program.** \$296,000 (BCRF) and three positions, to conduct annual rigid plastic packaging container compliance certification reviews, pursuant to recently adopted regulations, and provide additional compliance assistance tools.

## GOVERNOR'S PROPOSAL

**Beverage Container Recycling Reform.** The budget includes only minor proposals to continue efforts to reform the BCRP, despite the continued volatility in the fund and the department's strong effort to address specific fraud and audit requirements. These efforts have reduced the potential impact of fraud-related activities on the BCRF estimates. The budget does include a related proposal that may impact the department's ability to address specific deficiencies related to the BCRP. Specifically, the budget requests:

- **Minor Proposal—Position Request.** \$110,000 (Beverage Container Recycling Fund) and one permanent Associate Governmental Program Analyst, beginning in 2016-17, to provide programmatic and fiduciary oversight of expenditures in the Beverage Container City/County Payment Program. This proposal is consistent with the CalRecycle approved corrective action plan, in response to a 2014 BSA report. The requested position would provide additional collaboration, training, and technical assistance to participants in the program to ensure successful reporting and submittal of expenditure reports. This change would align this program with other CalRecycle payment programs to provide fiduciary accountability.
- **Cap-and-Trade Expenditure Proposal.** \$100 million (Greenhouse Gas Reduction Fund), conversion of nine positions to permanent, and an additional 17 positions to: (1) reduce methane emissions from landfills; and, (2) further greenhouse gas emission reductions in upstream management and manufacturing processes for organic and other recyclable materials. These programs support the expansion of existing, and the establishment of new, organic materials management facilities and recyclable commodities manufacturing facilities, as well as food waste prevention programs. The department's program (both loans and grants) are intended to result in commercial infrastructure for handling organic materials in food waste prevention projects (such as food rescue projects with food banks, food network projects that match generators with receivers, and to benefit food-insecure communities). Specific programs include in-vessel digestion facilities that produce biofuel and/or bioenergy to complement other alternative fuel programs in the state.

## ISSUES TO CONSIDER

**LAO Recommendations.** The LAO makes several recommendations that would help right-size the BCRP and shift the focus to programs that have demonstrated success. In order to do this, the Legislature would need to make several statutory changes and prioritize supplemental programs funded by the BCRP. Specifically, the LAO recommends:

- **Shift Processing Costs to Manufacturers.** The LAO recommends shifting processing costs to manufacturers. This would reduce BCRF expenditures significantly, probably eliminating the structural deficit. It would also require producers to cover the recycling costs of their

products, which means that these costs are incorporated or “internalized” into the total cost of the product when it is sold. Therefore, the price that consumers pay reflects the entire cost of the product—its production and disposal. Shifting costs to manufacturers could be done in two ways, either by eliminating processing fee offsets or by moving to a market-based system where manufacturers are responsible for the recycling of materials. While either approach could work, the LAO states that the market-based approach would have several potential advantages.

- **Improve Cost-Effectiveness of BCRP.** The LAO makes several recommendations designed to improve the cost-effectiveness of the BCRP: including (1) evaluating supplemental programs to determine how cost-effective they are at achieving recycling and litter reduction goals; (2) giving recyclers more flexibility in where they locate and piloting a new payment structure in order to improve convenience for consumers; and, (3) adjusting the administrative fee to reflect the actual costs of program participation. In combination, the LAO believes these recommendations would improve the program’s financial sustainability at current and potentially higher future recycling rates.

**Should the Legislature Re-Consider Trailer Bill Language to Reform the Program?** The department’s approach to the management of the BCRP, including responding to audits, focusing efforts to reduce fraud, and improving management of the fund overall, has resulted in a more robust forecasting of the BCRF. At this point the department has produced nearly as much reform as it can without legislative change. The Legislature should consider whether the time has come for a more comprehensive approach to policy change, focusing on offsets, for the program overall.

**Should the Legislature Consider Program Reform Offsets Using Greenhouse Gas Emission Reduction Funds?** The department proposes to use most of the greenhouse gas emission funding allocated to the department for methane reduction and upstream management in recycling and composting programs. The Legislature could, to the extent possible, direct the department to adjust its budget proposal to provide as much co-benefits to the BCRP offset programs in order to shore up the BCRF long-term. As long as the department continues to use the funds to reduce greenhouse gases, this would be an allowable use of the fund.

# Marijuana Cultivation: Environmental and Agricultural Protection Implementation

## BACKGROUND

**Legislative and Voter-Authorized Medical Marijuana Use.** The statutorily authorized use of medical marijuana in California dates back to November 1996, when California voters passed Proposition 215, the Compassionate Use Act of 1996 (CUA). The CUA provides Californians deemed “serious ill” the right to obtain and use marijuana for medical purposes, as recommended by a physician, and prohibits criminal prosecution or sanction against physicians who make medical marijuana recommendations. In 2003, Senate Bill 420 (Vasconcellos) Chapter 875, Statutes of 2003, established the Medical Marijuana Program under the California Department of Public Health, and created a medical marijuana identification card and registry database to verify qualified patients and primary caregivers. Participation in this identification program is voluntary.

**Production of Marijuana in California.** California produces more marijuana from outdoor “grows” (crops planted) than any other state. There are two basic ways marijuana is grown outside in the state. The first is illegal cartel use of public lands to grow marijuana. The second is the legal cultivation of marijuana on private lands pursuant to Proposition 215 (1996). The environmental impacts of growing marijuana on both public and private lands are well-documented. The Administration estimates that private land marijuana cultivation has expanded so much on the North Coast that Coho salmon, a state and federally-listed species, may go extinct in the near future if the problem is not immediately addressed. The State Water Resources Control Board (State Water Board) has observed significant land clearing activities resulting in sediment discharges to many high-value surface waters in the north state, nutrient loading from fertilizers, and stream diversions that result in dangerously low water levels.

Whether on public or private land, the impact from marijuana cultivation is substantial. By 2014, the Department of Fish and Wildlife (DFW) had conducted approximately 249 marijuana eradication and reclamation missions. These missions led to the arrest of 228 illegal marijuana growers, seizure of 72 firearms and over 5,000 pounds of marijuana. The state has collected approximately 66,000 pounds of trash, 332,000 feet of poly pipe, 14,000 pounds of fertilizer, 113 containers of common pesticides, herbicides, and rodenticides, 15 hazmat containers, and removed 105 man-made dams from waterways feeding illegal grows. Costs to reclaim damaged lands and remediate impacts range from \$2,000 to \$14,000 per acre on public land and as high as \$30,000 to \$50,000 per acre on private land.

During a period of eight months in 2014, marijuana seized had consumed over two million gallons of stolen water per day for in-ground plants. After thirty days, plants could have consumed over 64 million gallons of water, and with a typical growing period of 120-150 days, total consumption is likely to be significantly greater.

**Previous Budget Committee Actions and Oversight.** In 2014, the Senate Budget Subcommittee No. 2 began a series of oversight hearings on the environmental impacts of the production of marijuana in California, both legal (pursuant to Proposition 215) and illegal. In 2014, the Legislature approved trailer bill language to allow civil penalties to be used for marijuana enforcement by both the State Water Board and Department of Fish and Wildlife (DFW). The 2014 budget included \$1.5 million (\$500,000 General Fund, \$500,000 Timber Regulation and Forest Restoration Fund, and \$500,000 Waste Discharge Permit Fund) and seven positions to implement a task force and priority-driven approach to address natural resources damages from marijuana cultivation. The budget also included \$500,000 for the DFW from the general enforcement budget to the marijuana task force (activities that would have been funded by this money were backfilled by the Fish and Game Preservation Fund).

In 2015, the budget subcommittee continued its oversight role as well as addressed the increasingly critical statewide drought. Urgency actions in March authorized \$4 million (General Fund) for the State Water Board and DFW to enhance instream flows in at least five stream systems that support critical habitat for anadromous fish. While this action was not intended to solely address marijuana cultivation, the infusion of funding improved the board's ability to assess these streams.

The 2015 budget also included \$1.5 million (General Fund) and eleven, two-year limited-term positions to continue implementation of the task force and the priority-driven approach to address the natural resources damages from marijuana cultivation, primarily on private lands in northern California, but also through targeted in-partnerships with DFW on high conservation value state public lands.

**2015 Legislative Package.** Since 2003, advocates, patients, and local governments have recognized some deficiencies in oversight and called for additional safety regulations. In June 2015, Governor Brown signed the Medical Marijuana Regulation and Safety Act, comprised of three bills to address the multi-faceted regulatory and enforcement necessitated by the growth of this industry. These measures consist of:

- **Watershed Task Force.** AB 243 (Wood), Chapter 688, Statutes of 2015, provides for the permanent establishment of a multiagency task force to address the environmental impacts of marijuana cultivation in the watershed. The bill establishes guidelines and regulations for medical pot cultivators, but takes an environmental approach. It gives the State Water Board the explicit authority to regulate the discharge of water, chemicals and sediment into the environment.
- **AB 266 (Bonta), Chapter 689, Statutes of 2015.** AB 266 establishes a new agency within the Department of Consumer Affairs, the Bureau of Medical Marijuana Regulation, to oversee the licensing rules for medical pot growers, the makers of the products and retailers. The agency will be assisted by the California Department of Food and Agriculture, the Department of Public Health and other state agencies.
- **SB 643 (McGuire), Chapter 719, Statutes of 2015.** SB 643 focuses on clinics that capitalized on the lack of regulation by issuing medical marijuana prescriptions to patients

who lacked valid health needs. It also creates licensing and other regulations to oversee the industry.

**GOVERNOR’S PROPOSAL**

The budget provides four major proposals in the resources, environmental protection and agricultural areas. While the proposals directly implement the legislation referenced in the 2015 medical marijuana legislative package, the heart of the package is to bring marijuana, both legal and illegal, under the umbrella of current state statutes. So, for example, where pesticides are used on medical marijuana, the Department of Pesticide Regulation has a duty to protect both consumers and cultivators from the impacts of pesticide use on the crop. So, too, the State Water Board and DFW must protect the state’s waterways, fish and wildlife from the impacts of both legal and illegal cultivation. Perhaps the true new program to be developed under this package is the California Department of Food and Agriculture (CDFA) proposals to establish management and tracking of marijuana as a new, and legal, crop—with greater reporting than other, established crops, due to its high profile.

In general, the proposals to protect fish and wildlife and instream flows constitute a slight change in the way the state has approached environmental protections. In keeping with legislative and executive changes over the previous years, and in particular related to ongoing drought and weather fluctuations, the approach focuses on maintaining clear and clean water in rivers and streams, at a level to sustain fish and wildlife and to meet other legal diverters’ needs. While this is the basis for water law in California, the Administration’s new approach focuses more intensely on the relationship between water rights and water diversions.

**Medical Marijuana  
Governor’s Environmental Protection and Agriculture Proposals  
(Dollars in Millions)**

<b>Purpose</b>	<b><u>2016-17</u> (Proposed)</b>	<b><u>2016-17</u> (Proposed)</b>	<b>Fund Source</b>
Department of Fish and Wildlife	\$7.6	\$5.8	General Fund
State Water Resources Control Board	5.2 0.5	6.0 0.7	General Fund WDPF <sup>1</sup>
Department of Food and Agriculture	0.7	0.7	DPR Fund <sup>2</sup>
Department of Pesticide Regulation	<u>3.3</u>	<u>3.3</u>	MM Fund <sup>3</sup>
<b>Total**</b>	<b>\$17.3</b>	<b>\$16.5</b>	

<sup>1</sup> Waste Discharge Permit fund

<sup>2</sup> Department of Pesticide Regulation Fund

<sup>3</sup> Medical Marijuana Regulation and Safety Act Fund

**Department of Fish and Wildlife.** The budget requests \$7.7 million (General Fund) and 31 positions to address two specific aspects of AB 243 (Wood). Specifically, the requests include:

- **Multi-Agency Task Force.** Fish and Game Code 12029(c) requires the department to establish a permanent multi-agency task force to address the general environmental impacts of marijuana cultivation. The requested funds will be used to expand enforcement efforts on a statewide level to ensure the reduction of adverse impacts on fish and wildlife and their habitats.
- **Water Diversions.** In coordination with the State Water Board, the department proposes to use resources to ensure that individual and cumulative effects of water diversion and discharge associated with cultivation do not affect the instream flows needed for fish spawning, migration, and rearing, and the flows needed to maintain natural flow variability.

**State Water Resources Control Board.** The budget has two distinct water quality requests:

- **Water Quality.** The State Water Board requests \$1.8 million (\$1.3 million General Fund and \$472,000 Waste Discharge Permit Fund) for 13 positions to extend the north-state focused marijuana regulation task force pilot project statewide. The pilot project is a task force directed by the Legislature to address the natural resources damages from marijuana cultivation, primarily on private lands in northern California as well as targeted state-managed lands. This request is in addition to the \$1.4 million the Legislature previously appropriated, including 11 limited term positions that are scheduled to end this in the budget year. The funding level proposed will allow the State Water Board to implement a more credible water quality protection and enforcement program in the three priority regions of the state where marijuana cultivation has the most adverse environmental impacts.

As with other major State Water Board actions, the joint water quality project will focus on the core functions mandated under general water quality laws including: (1) permitting; (2) enforcement; (3) education and outreach; and, (4) comprehensive planning. A significant amount of marijuana cultivation is occurring either illegally or quasi-illegally (non-permitted), and the board cannot charge WDPF fees until a legitimate, legal operation is identified. Thus, the General Fund has been proposed as the funding source at this time.

- **Water Rights and Instream Flow Request.** The budget requests \$3.9 million (General Fund) and 22 positions to comply with legislatively-mandated instream flow requirements so that individual and cumulative impacts of water diversion and discharge necessary for fish spawning, migration, rearing are addressed.

As with other water-rights mandates, the State Water Board will focus on: (1) establishment of interim flow requirements to provide immediate and minimal protection of fishery resources; (2) tailored regional policies for appropriation of water to limit further degradation of impacted streams; and, (3) permitting and registration of water diversions associated with legal and illegal marijuana cultivation activities. As with the previous request, the board cannot charge the Water Rights Fund fees until a legitimate, legal operation is identified. Thus, the General Fund has been proposed as the funding source at this time.

**Department of Pesticide Regulation.** The budget requests three positions and \$700,000 from the Department of Pesticide Regulation Fund to implement AB 243. AB 243 requires the department to develop new types of assessments for the risks associated with inhalation of pesticide use on marijuana, as well as the dietary (ingestion) risk associated with marijuana pesticide use. The department proposes to use contract funds to work with an external research program to assist with analyzing current marijuana cultivation and cultural practices, pests of concern, and treatments, including pesticide use. The department is also charged with developing guidelines and outreach to protect the cultivators of medical marijuana from pesticide exposure.

**Department of Food and Agriculture.** The budget requests \$3.3 million reimbursement authority and 18 positions to be funded by the Medical Marijuana Regulation and Safety Act Fund (MMF), ongoing. The series of bills passed in 2015 mandate that CDFA (1) establish a Medical Marijuana Cultivation Program (MCCP) to license the cultivation of indoor and outdoor medical marijuana, with consideration given to size and location of the operation; (2) establish a track and trace program that uniquely identifies medical marijuana plants; (3) work in consultation with other state agencies to adopt environmental remediation regulations, and consider and implement best practices, and to establish pesticide use standards; and (4) establish an electronic database that can be accessed by the Bureau of Medical Marijuana Regulation housed under the Department of Consumer Affairs (DCA). Under the recent legislative package, the department is given authority to conduct verification inspections, enforcement language, provisions to promulgate regulations, and is required to prepare a report to be submitted to the Legislature annually beginning in 2023.

## ISSUES FOR CONSIDERATION

**How will the Department of Food and Agriculture (CDFA) regulate the marijuana industry with respect to legal cultivation standards?** As a basis for moving forward, it should be acknowledged that marijuana is one of the first crops to be moved from illegal to legal status, for the purposes of agricultural production. The CDFA budget proposal acknowledges that, until this point, mainly local regulations were focused on the cultivation of marijuana (mainly indoor). How will CDFA approach the licensing of the cultivation of both indoor and outdoor marijuana crops and coordinate with the Department of Pesticide Regulation, Local Agricultural Commissioners, and Department of Public Health, to ensure both the safe production and harvest of this product?

**How should the State approach Instream Flow?** The environmental and natural resources proposals focus on an instream flow approach. How will the Department of Fish and Wildlife and State Water Board coordinate water rights, fish needs and flow regimes? This is in keeping with the Legislature and Administration's more intense focus on water in recent years due to drought. The body of law protecting instream flows is robust, however it may be necessary to clarify statute, as has been done in the past with certain drought-related laws, in order to achieve a high degree of success with the instream flow approach. The Legislature may wish to consider whether: (1) the instream flow approach would take longer to implement than a more direct regulatory approach; and (2) legislation is necessary to improve the efficiency of the instream flow approach.

**Do the departments anticipate shifting funding to the new medical marijuana fees, and should the Legislature consider a sales tax on marijuana?** During the interim period as marijuana production is brought under the regulatory umbrella, the state is providing significant General Fund to manage the environmental and natural resources damages from legal and illegal cultivation. So, too, General Fund is necessary to continue the multi-agency task force. The Legislature should consider: (1) how and when should the state shift programs and activities to medical marijuana fees; and, (2) should fees not be appropriate, if a sales tax on marijuana would be appropriate to cover other program expenditures that are not eligible for fees?

**How will the Department of Consumer Affairs (DCA) coordinate with the multitude of diverse departments regulating marijuana?** A new bureau, established under the Department of Consumer Affairs, oversees the state's efforts on marijuana cultivation and manages the funding stream established by the 2015 legislative package. DCA has very little experience with environmental or natural resources activities, and health and food safety mandates. How will the departments coordinate with this new bureau and will the departments have access at appropriate times to the funding available through DCA?

**How will the Administration continue to protect permitting personnel as they move toward registering more growers legally?** As has been established by DFW wardens in their investigation of both legal and illegal growing operations, the permitting and enforcement of marijuana cultivation is a dangerous business. State permitting personnel are not law enforcement officers and their protection is critical to moving forward with the establishment of a normal and legal process for monitoring marijuana cultivation. How does, and will, the Administration continue to provide adequate protection to those monitoring marijuana cultivation and is the funding provided in the budget sufficient to the task?

**Pesticide regulations and risk assessments can take multiple years. Can the departments develop emergency or interim regulations to maintain the public and environment's safety through the transition period?** Finally, the budget provides funding to the Department of Pesticide Regulation through the DPR Fund for risk assessment on legal medical marijuana production. How will the department: (1) assess the fees on production of the product; (2) provide enforcement and testing for products that are sold in dispensaries that may have illegal pesticide residues; and (3) move in an expedited manner to establish clear risk assessments for production of this product given high number of consumers in the state?

# Beyond Fire Protection: Managing Wildlands for Watershed Protection and Forest Health

## BACKGROUND

**Defining Forest Health.** Forest health is a loosely-defined term for the broad array of services provided by the forest environment, including ecological health, economic value, social benefit and watershed value, among others. California had struggled with the management of the state's forest health over the years, in particular balancing the needs of homeowners in the forested area with the management of the greater forest ecosystem. The Department of Forestry and Fire Protection (CalFIRE), is the state's lead agency managing this balance, in conjunction with the Board of Forestry, Natural Resources Agency, Department of Fish and Wildlife, State Water Resources Control Board, and other state agencies, including state conservancies.

CalFIRE is charged with the management and protection of the forests and wildlands, and in particular the specific management of the State Responsibility Area (SRA) as part of a multi-agency and government program to manage forest and timberlands, including for wildfire protection. Of the 85 million acres classified as wildlands in the State, 33 million acres are forest lands, with 38 percent privately-owned and 62 percent government-owned or tribal. The state's 20 million acres of commercial forest lands grows 8.3 billion board feet yearly. The five-year average timber harvest volume and value is approximately 1.3 billion board feet, and \$326 million, respectively.

**Forest Science Focuses on Ecosystem Services and Watershed Protection.** In order to understand the value of wildlands, and in particular forest health, it is important to identify the benefits of a healthy forest. A healthy forest, in particular in California, reduces flooding (by allowing water to infiltrate the ground), improves water quality (in part by reducing sediment from roads, development or wildfire debris), increases groundwater recharge, improves air quality, and adds value of aesthetics and increases property values, including timber values. One of California's primary goals of forest health is watershed protection, as much of the state's water is derived from the mountain and forest environment, from snowpack to groundwater that feeds into streams and rivers downstream.

According to the US Environmental Protection Agency (US EPA), in its report 841-N-12-004, "Healthy intact watersheds provide many ecosystem services that are necessary for our social and economic well-being. These services include water filtration and storage, air filtration, carbon storage, nutrient cycling, soil formation, recreation, food and timber. Many of these services have not been monetized and therefore the economic contributions of healthy intact ecosystems are often under-valued when making land use decisions. Ecosystem services provided by healthy watersheds are difficult to replace and most often expensive to engineer. An engineered ecosystem service replacement may only provide a fraction of the services provided by highly functioning natural systems."

The US EPA goes a step further and defines some of the greater economic values of an intact forest ecosystem and protected watershed including: (1) lower drinking water treatment costs; (2) avoidance of expensive restoration activities; (3) sustained revenue-generating recreational and tourism opportunities; (4) reduced vulnerability and damage from natural disasters; and, (5) provision of a long-term economic foundation for future generations.

The US EPA's focus on forest and watershed health is in keeping with the broad array of economic and ecological scientific work on forest health. However, the encroachment of development, previous timber practices, and land management in the forest environment has made the realization of these values challenging. So, too, both the increasing risks from climate change and wildfire suppression tactics over the years have taken a toll on broader forest health. State agencies have, in some cases, become simply reactive to these immediate threats.

**How do Other Entities Pay for Forest Ecosystem Services, Particularly Watershed Protection?** Using the premise that watersheds provide an economic value to downstream water users, several states and local jurisdictions have implemented watershed fees to promote non-wildfire suppression costs. In order to make the case for the costs to downstream users, these states had to focus on watershed health as a priority. The State of New York, in a 2007 agreement for filtration avoidance, committed to promoting natural resources security by funding watershed protection programs rather than construction of water filtration facilities. The state demonstrated the potential for significant cost savings (\$5 to \$7 billion) between construction of new filtration plants and restoring the integrity of the largest unfiltered water supply system in the US.

Closer to home, both the Tualatin River Basin in Oregon State and the San Francisco Public Utilities Commission have instituted broad watershed health programs to avoid downstream costs. In all cases, the approach started with valuing the watershed as an intact system, and then focusing on cost reduction to downstream users.

**How Does California Pay for Broader Forest Health Ecosystem Services?** California has a piecemeal approach to forest ecosystem health. Three state conservancies (Tahoe, Sierra Nevada and Coastal), provide grants and projects for opportunity forest health projects. These are dependent on voter-approved bonds and annual appropriation by the Legislature. Similarly, the Wildlife Conservation Board provides land acquisition and conservation easements, again subject to voter-approved bonds and one-time appropriations. AB 1492 (Blumenfeld), Chapter 289, Statutes of 2012, was passed to implement forest restoration components of a timber regulation and forest restoration program reform. A portion of funding derived from the tax on lumber is intended to provide funding for forest health projects. This, too, is subject to one-time appropriation. In the 2015 Budget Act, \$5.2 million was appropriated from the AB 1492 funds to CalFIRE for forest restoration grants within the California Forest Improvement Program. Other programs at CalFIRE focus mainly on fire prevention, rather than the broader focus outlined by the US EPA.

**State and Federal Focus on Fire Prevention and Suppression of Wildfires.** Over the past few decades, the state and federal government have focused much of their efforts on suppression of wildfires. In a commentary led by UC Davis scientists published in the Journal Science, the

investigators report that annual funding for forest management consists mainly of wildfire suppression funding. This is consistent with the state's approach to forest management. In part, this can be explained by the high economic and social values lost when major wildfires take place. The report states that 98 percent of wildfires are suppressed before reaching 300 acres, yet the two percent that escape containment account for 97 percent of fire-fighting costs and total burned areas. State and federal funding for fuels reduction, prescribed burns and intact forest health are not provided annually and regularly, leading to further imbalance. The cost to individuals and communities goes beyond economic cost, and losses are often not irreplaceable.

**Shift to Wildfire Suppression Increases Costs to CalFIRE.** Consistent with the national focus on wildfire suppression, CalFIRE has shifted to a more aggressive wildfire suppression method. As evidenced by the number of firefighting activities funded in the budget, the state's main foresters have a primary focus on life and property protection, in part due to public expectations for fire and emergency rescue. The department, as part of its mutual aid approach, responds to numerous life emergencies, including health calls, and manages the growing number of calls for wildland fire suppression. Employees of the department are all required to train in firefighting, even if they are solely focused on forest health. When major incidents occur, it is not uncommon for "all-hands" to be assigned to a fire suppression effort. CalFIRE has a long record of managing major wildfire incidents in a professional and efficient manner, often taking on suppression activities in federal or local jurisdictions (as part of mutual aid) in order to protect the state's economic and social values associated with wildlands. Although most known for large wildfire incidents, CalFIRE is also often directed by the Governor to handle the incident command for man-made or natural disasters such as flood, earthquake, or other events.

## GOVERNOR'S PROPOSAL

**Governor's CalFIRE Forest Health Proposal.** The budget requests \$180 million (Greenhouse Gas Reduction Fund [GGRF]), one-time, with position authority and associated funding (approximately \$8 million per year) through 2021-22, for a forest health program that is intended to secure forest carbon and reduce greenhouse gas (GHG) emissions. Funds will support the expansion of the Urban and Community Forestry, and Forest Legacy Program, and target landscape-scale forest health projects in high-priority forested upper watersheds in coordination with the Department of Fish and Wildlife (DFW), to realize the largest direct benefit for GHG reduction, forest resilience and co-benefits, such as protection of water, wildlife habitat, and rural economic stability. Of the amount proposed in the budget, \$140 million is directed to the Forest Legacy Program and landscape-scale forest health projects, which directly funds projects within the forest (other programs are mainly to address urban greening and forestry issues).

The proposed funding is intended primarily to address wildfire risk. In coordination with federal counterparts and research institutions, CalFIRE has collected forest land spatial data showing a significant increase in insect (beetle bark) disease and moisture-stress related tree mortality during the current extended drought. The best available science indicates that these areas are more prone to high severity fire. In addition, the dead, decaying and dying trees emit greenhouse gases and lose carbon storage. On the other hand, addressing this situation could work against the benefits derived from allowing a certain portion of dead and decaying trees to populate the forest in order to increase water storage and biodiversity.

**Forest Legacy Program.** The department plans to coordinate efforts to treat forest health at a landscape scale, with both in-house and grant programs that will address reforestation, pest and disease-affected tree removal, fuel reduction and thinning, and vegetation management. The specific activities associated with this proposed program are unclear, but are outlined in broad terms focused on forest health and wildfire prevention.

**Land Conservation and Easements.** Funds will be used to purchase conservation easements to prevent working forests from being converted to non-forest use (vineyards, housing, marijuana cultivation), and placed under more intensive land management to effect net GHG reductions. The department proposes to work with the Wildlife Conservation Board (WCB) on real estate property acquisition processes to facilitate the sale or transfer of real property. The WCB has managed numerous programs to this effect in recent years. The budget requests two positions: a level one forester to support program administration and operational function, and a level two forester to facilitate conservation easement development, provide public outreach and education on the application process, assist in conservation easement monitoring, review and develop program reports, and make recommendations for further development implementation. The budget also requests additional forester and environmental scientist positions to function as biomass research specialists, and to provide supervision of the overall forest health program. Pursuant to internal rules, these positions will be required to attend the firefighting academy, regardless of their role in firefighting.

**Budget Bill and Trailer Bill Language.** Finally, the proposal includes proposed budget bill language to allow the department to use funds for either support of the department, provide local assistance or fund capital outlay. Funds are requested to have an encumbrance period of six years. Trailer bill language requests the department be allowed to enter into cooperative agreements with state, federal, Native American, or local agencies for administration of the programs.

**Governor's Tree Mortality Task Force.** In response to the high wildfire risk associated with tree mortality due to drought, the Governor, through CalFIRE, instituted a Tree Mortality Task Force. CalFIRE, as lead agency, created an incident command structure to accomplish the tasks set before the task force. The task force is comprised of state and federal agencies, local governments, utilities, and various stakeholders that will coordinate emergency protective actions, and monitor ongoing conditions to address the vast tree mortality resulting from four years of unprecedented drought and the resulting bark beetle infestations across large regions of the state. The objectives of the task force are separated into two categories—management objectives and working group objectives. The activities of these two efforts are listed below and will serve to inform the department's broader efforts for forest health and landscape-scale projects.

**Task Force Management Objectives:**

- Provide for public health and safety of persons and property in identified high hazard zones.
- Ensure efforts associated with implementation of the directives contained in the Governor's State of Emergency Proclamation remain coordinated.

- Ensure continuous communication among state, federal, and local governments, as well as with other non-governmental organizations assigned to the task force.
- Provide consistent and coordinated messaging between task force member agencies and the public.
- Manage projects and programs in a financially responsible and efficient manner.

**Task Force Working Group Objectives:**

- Identify existing efforts to mitigate tree mortality in high hazard zones.
- Identify an organizational structure and plan of action.
- Establish working groups, as appropriate, to address various aspects identified in the Governor's State of Emergency Proclamation.
- Facilitate the information flow between state, federal, tribal and local government utilities, and other non-governmental organizations on efforts towards meeting the items addressed in the Governor's State of Emergency Proclamation.
- Ensure project activities and resources are coordinated.
- Identify potential funding sources.
- Coordinate with other state-level initiatives, such as the Forest Climate Action Team and California Forest Biomass Working Group.
- Identify and evaluate the availability of wood products markets, and determine whether expanded wood products markets can be developed.
- Develop and maintain a website for the dissemination of information.

**ISSUES FOR CONSIDERATION**

**Are We Valuing the Ecosystem Benefits of Intact Forest Ecosystems?** The US EPA makes a compelling case that there are values in forest health, in particular with intact forest ecosystems, that government and society may not be taking into account. As a result, it is hard for the state to clearly define a budget for baseline forest ecosystem health beyond wildfire prevention and suppression. The Legislature may wish to request that the Natural Resources Agency, in conjunction with the California Environmental Protection Agency, dedicate a portion of funding from AB 1492 in order to determine what baseline activities would be appropriate for ongoing funding, and to which departments these activities should be assigned.

**What Should be the Role of the Various State Departments Focused on Forest Health?**

Although CalFIRE remains the lead on forest health for the state, the massive role of wildfire prevention and suppression takes up most of CalFIRE's time and management. A great many of the one-time activities of the state's major conservancies, DFW, WCB and Natural Resources Agency, are dedicated to broader forest health. Given that there may be ongoing funding from the cap-and-trade program, as well as a smaller amount from AB 1492, the Legislature should consider which departments provide the greatest value when it comes to ecosystem services and intact forest health.

**What Should be the Role of the Wildlife Conservation Board?** CalFIRE states that it plans to work with WCB staff on a real property acquisition process to facilitate the sale or transfer of development rights and property. This is the expertise of the WCB and having CalFIRE contract or work with WCB seems to add a step of work that is unnecessary. Would it not be more efficient to simply give the WCB funding for this purpose and allow them to run a grant program similar to any number of acquisition and development programs they have successfully managed over time?

**What Lessons Can we Learn From Other State and Local Funding Programs?** As discussed, other state and local agencies have taken time to value the forest ecosystem, including the difficult decision to maintain portions of the watershed, as intact forest systems. This does not preclude other activities within the watershed but restricts the types of activities that would impact downstream users. In order to pay for these services, downstream users are charged a nominal amount to support watershed protection programs. The Legislature should consider whether a charge on water bills would be appropriate for a broader forest landscape program, and if so, who would be the beneficiaries of this program and how much is needed.

**Is There a Long-Term Benefit to Diversifying Forestry Personnel? Should These Activities be Conducted Largely as Grants or by State Personnel?** One benefit of one-time funding is that the state does not need to add significant ongoing personnel to staff programs, including retirement costs. However, the down-side of this is the lack of continuity and expertise associated with program management. At CalFIRE, all personnel are trained to be firefighters and thus their benefits include an earlier retirement plan (due to the challenging physical nature of active firefighting) whether or not they actually perform firefighting duties. The state should consider, as it has with the State Parks Department when it allowed a parallel professional track for non-peace officer status park superintendents, whether or not long-term savings and separate expertise would be appropriate for certain foresters and environmental scientists working on landscape-level forest health programs.

**Should the Legislature Allow CalFIRE to Shift Funding Between Support, Local Assistance and Capital Outlay?** Finally, the CalFIRE budget proposal requests budget and trailer bill language to allow for funding to be shifted between support, local assistance and capital outlay. Perhaps symptomatic of a program that has not been fully developed; this type of action reduces the Legislature's control and oversight of funding for specific purposes. It should be clear, prior to appropriation, whether the money will be used for grants, state operations or state capital projects. The Legislature should consider specifying these programs prior to appropriation so that the need for the budget and trailer bill language is eliminated.

# Transportation Funding

## BACKGROUND

### Overview of Transportation Funding in California

The California state highway system includes 50,000 lane-miles of pavement, approximately 13,000 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 are responsible for 304,000 miles of local streets and roads, as well as numerous local bridges. Approximately, 180 public agencies provide public transit, such as intercity bus and passenger rail, resulting in about 1.3 billion passenger trips each year. 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 local, state, and federal sources 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 a later section of this report.

### Major Sources of California Transportation Funding

Funding Source	Comments
Local Revenues	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.
Federal Revenues	Primarily federal gas tax revenue (18.4 cents/gallon). Includes funds for highways and transit.
Motor vehicle fuel taxes	Allocated to the state and local governments. In 2016-17, the state gasoline tax is expected to be 27.8 cents and the diesel excise tax 15.9 cents.
Fees on cars and drivers	Primarily from vehicle registration and driver licenses. Supports the operations of the DMV, CHP, and ARB.
Truck weight fees	Revenue pays for debt service on transportation-related general obligation bonds.
Cap-and-trade	Supports transit operations and capital projects, and active transportation.
Diesel sales tax	Primarily supports local transit operators.
GO bonds	State general obligation bonds, primarily from Prop 1B.

**Special Session on Transportation Funding**

The Legislature convened in 2015 a special session on transportation funding to address the funding shortfall that has resulted in the state highway system, transit, and local streets and roads not having adequate funding to maintain the current system. For example, funding for the State Highway Operation and Protection Program, which funds highway maintenance and repairs, has an annual funding shortfall of about \$6 billion. Various options to increase state funding and achieve efficiencies at Caltrans have been proposed by the Legislature and the Administration. Generally, the total amount of funding the proposed plans would generate each year (for a variety of transportation purposes) is from the low billions to up to \$7 billion. Below, is a comparison from the Legislative Analyst’s Office (LAO) in October 2015, of the major proposals being considered at that time. Subsequently, AB 1591, by Assemblymember Frazier, was introduced, a proposal that would raise over \$7 billion annually for investments in trade corridor improvements and road maintenance and rehabilitation.

**Major Transportation Funding Special Session Proposals**

Governor	Senate Committee <sup>b</sup>	Senate Republican	Assembly Republican
<b>New Taxes<sup>a</sup></b>			
<p><b>\$3 Billion Annually</b></p> <ul style="list-style-type: none"> <li>• \$65 vehicle registration fee</li> <li>• 6 cents per gallon gasoline excise tax</li> <li>• 11 cents per gallon diesel excise tax</li> <li>• Index gasoline and diesel excise tax rates for inflation</li> </ul>	<p><b>\$4.6 Billion Annually</b></p> <ul style="list-style-type: none"> <li>• \$70 from two vehicle registration fees and \$100 additional fee for zero emission vehicles</li> <li>• 12 cents per gallon gasoline excise tax</li> <li>• 22 cents per gallon diesel excise tax</li> <li>• Index gasoline and diesel excise tax rates for inflation</li> <li>• 3.5 percent diesel sales tax</li> </ul>	—	—
<b>Allocate Existing Revenue<sup>a</sup></b>			
<p><b>\$600 Million Annually</b></p> <ul style="list-style-type: none"> <li>• \$500 million from cap-and-trade</li> <li>• \$100 million Caltrans efficiency savings</li> </ul>	<p><b>\$400 Million Annually</b></p> <ul style="list-style-type: none"> <li>• \$400 million from cap-and-trade</li> </ul>	<p><b>\$2.9 Billion Annually</b></p> <ul style="list-style-type: none"> <li>• \$1.9 billion from cap-and-trade</li> <li>• \$1 billion from weight fees</li> </ul>	<p><b>\$4.4 Billion Annually</b></p> <ul style="list-style-type: none"> <li>• \$1.2 billion from cap-and-trade</li> <li>• \$1 billion from weight fees</li> <li>• \$1 billion General Fund</li> <li>• \$685 million from vacant positions</li> <li>• \$500 million Caltrans efficiency savings</li> </ul>
<b>One-Time Funding<sup>a</sup></b>			
\$879 million in loan repayments	\$1 billion in various loan repayments	\$2.4 billion in various loan repayments	
<p><sup>a</sup> Revenue estimates provided by proponents of each proposal.  <sup>b</sup> Proposals approved by the Senate Transportation and Infrastructure Development Committee.</p>			

Source: Legislative Analyst’s Office

**Options to Increase the Accountability and Efficiency of Caltrans**

As mentioned above, in addition to the proposals to increase funding for transportation infrastructure, many of the options being considered would also increase the accountability of Caltrans’ work and allow for other efficiencies. Over time, increasing the accountability and efficiency of Caltrans has the potential to decrease the amount of funds that are potentially mismanaged, reduce cost-over runs, and reduce total project costs. The savings from implementing such activities would be far less than the funding proposals described earlier. However, improving the department’s performance and better ensuring that the limited funding available for transportation is put to the best use also should be a priority. The major accountability and efficiency proposals being considered are summarized in the table below.

**Major Accountability and Efficiency Special Session Proposals**

Governor	Senate Committee <sup>a</sup>	Senate Republican	Assembly Republican
<b>Accountability</b>			
Requires Caltrans to meet certain performance standards	<ul style="list-style-type: none"> <li>Requires CTC oversight of SHOPP projects</li> <li>Creates a transportation Inspector General</li> <li>Requires Caltrans efficiencies</li> </ul>	<ul style="list-style-type: none"> <li>Requires CTC oversight of SHOPP projects</li> <li>Creates a transportation Inspector General</li> </ul>	—
<b>Procurement Methods</b>			
Extends P3 authority by ten years and allows construction manager general construction method for 12 additional projects	—	Permanently extends P3 authority	Permanently extends P3 authority
<b>Other</b>			
<ul style="list-style-type: none"> <li>CEQA exemptions for certain types of projects</li> <li>Constitutional restrictions on new revenue</li> </ul>	<ul style="list-style-type: none"> <li>Constitutional and statutory restrictions on existing and new revenue</li> </ul>	<ul style="list-style-type: none"> <li>CEQA exemptions for certain types of projects</li> <li>Increases Caltrans use of consultants</li> <li>Constitutional restrictions on existing and new revenue</li> </ul>	—
<sup>a</sup> Senate Transportation and Infrastructure Development Committee. CTC = California Transportation Commission; SHOPP = State Highway Operation and Protection Program; P3 = public-private partnership; and CEQA = California Environmental Quality Act.			

Source: Legislative Analyst’s Office

In addition, the California Transportation Commission in its 2015 annual report made recommendations to the Legislature that would increase accountability and efficiency. These include:

- Require the State Highway Performance Plan to include measurable targets for improving the state system, and require Caltrans to provide regular reports on its progress to the California State Transportation Agency and the commission.
- Allow direct contracting between Caltrans and federally-recognized Native American Tribes in California for transportation program purposes.

- Provide flexibility for Caltrans to contract for more engineering and right-of-way workload. Permit Caltrans to prequalify consultants by type of work and draw from a list as work becomes available. Authorize Caltrans and its partners to use alternative procurement methods permanently and without limits.
- Require Caltrans to implement efficiency measures with the goal of generating \$100 million per year in savings to invest in maintenance and rehabilitation of the state highway system.

### **Motor Vehicle Account Fund Condition**

The Motor Vehicle Account (MVA) was created to support the state's activities related to the administration and enforcement of laws regulating the operation or registration of vehicles used on public streets and highways, as well as to mitigate the environmental effects of vehicle emissions. In 2015–16, \$3.7 billion is estimated to be deposited into the MVA with vehicle registration fees accounting for \$2.7 billion (73 percent) and driver license fees accounting for \$303 million (eight percent). The remaining revenue primarily comes from identification card fees, late fees associated with renewals, and miscellaneous fees for special permits and certificates. Between 2009–10 and 2014–15, revenues increased at an average rate of five percent annually.

Vehicle registration fees consist of two components—a base fee of \$46, and an additional fee of \$24 that directly benefits CHP. The base vehicle registration fee was last increased in 2011, from \$34 to \$46. In 2014, the CHP fee increased from \$23 to \$24 and was indexed to the Consumer Price Index (CPI), allowing the fee to automatically increase with inflation. The current driver license fee is \$33 and was last increased by \$1 in 2014. The driver license fee is also indexed to the CPI.

In recent years, MVA expenditures have increased at a higher rate than revenues deposited into the fund. Last year, the LAO forecast of MVA revenues and expenditures indicated that the MVA's fund balance would be depleted by 2017–18, resulting in insolvency. This forecast includes revenue estimates based on historical trends and expenditure estimates based on proposals already approved by the Legislature (such as the multiyear replacement of CHP's aircraft) and the proposed replacement of DMV offices. The forecast also included out-year expenditures related to the annual CHP officer salary increases. The LAO recommended at that time, that the Administration take steps to prevent future operational shortfalls.

## **GOVERNOR'S PROPOSAL**

### **Transportation Funding and Reform Package**

The budget incorporates the transportation funding plan the Administration proposed in September 2015 during the transportation special session. The budget proposes the plan would provide new funding of \$1.7 billion in 2016-17, and \$3.6 billion on an annual ongoing basis. The annual funding package provides \$2 billion from a new \$65 fee on all vehicles; \$500 million by setting the gasoline excise tax at 18 cents (includes future adjustments for inflation); \$500 million from an 11-cent increase in the diesel excise tax; \$500 million in additional cap-and-trade proceeds; and \$100 million from cost-saving reforms to be implemented by Caltrans as shown in the figure below. The \$1.7 billion of additional funding in 2016-17 includes

\$173 million from the acceleration of General Fund loan repayments over the next four years (\$879 million in total repayments), rather than repaying these loans over the next 20 years.

**The Administration’s 2016-17 Transportation Funding and Reform Package**

Funding Source	Annual Amount	Comments
Road improvement charge	\$2 billion	A new \$65 fee on all vehicles that equally funds state and local transportation priorities.
Gasoline excise tax	\$500 million	Sets the gasoline excise tax at the historical average of 18 cents beginning in 2017-18 and going forwards adjusts annually for inflation.
Diesel Excise tax increase	\$500 million	Increases the diesel excise tax by 11 cents beginning in 2017-18 and going forwards adjusts annually for inflation.
Cap-and-trade	\$500 million	Implements a new carbon road program (\$100 million) and funding for transit capital improvements (\$400 million).
Caltrans efficiencies	\$100 million	Implements cost-savings reforms.

Proposals for spending the increased funding are:

- **Local Streets and Roads.** The increased funding will provide \$342 million to cities and counties for local road maintenance and \$148 million in loan repayments will reimburse cities and counties for funds already spent on Traffic Congestion Relief Programs.
- **Low Carbon Road Program.** The budget provides \$100 million cap-and-trade revenues for a new Local Carbon Road Program for local projects that encourage active transportation such as bicycling and walking, with at least 50 percent of the funds going to disadvantaged communities.
- **Transit and Intercity Rail Capital.** For transit and intercity rail capital expenditures, \$400 million from cap-and-trade revenues (and \$9 million from loan repayments) for transit capital investments that provide greenhouse gas reductions, with at least 50 percent of the funds going to disadvantaged communities.
- **Highway Maintenance and Repair.** The budget provides an increase of \$515 million (\$5 million from loan repayments) for repairs and maintenance on the state highway system.
- **Trade Corridor Improvements.** The budget provides an increase of \$211 million (\$11 million from loan repayments) for Caltrans to fund projects along the state’s major trade corridors.
- **Reforms and Efficiencies.** The budget proposes to improve Caltrans’ performance by establishing measurable targets for improvement. Also, proposes to streamline project delivery by making various changes that include advancing project environmental mitigation,

implementing more innovative procurement, allowing Caltrans to deliver projects funded with new revenues by doubling contract staff over the next five years, and extending the sunset date for public-private partnerships through 2027.

### **Increased Funding for the Motor Vehicle Account**

The budget proposes to increase the vehicle registration fee by \$10 to address the looming shortfall in the Motor Vehicle Account of about \$500 million. This would raise the vehicle registration fee to \$56. As required by current law, \$53 of this amount would go to the MVA, two dollars would be deposited into the Alternative and Renewable Fuel and Vehicle Technology Fund, and one dollar (\$1) would be deposited into the Enhanced Fleet Modernization Subaccount.

## **ISSUES TO CONSIDER**

The current level of funding is inadequate to maintain the state's transportation system and it is important for the Legislature to address this. 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. Obtaining the necessary votes to enact a new transportation funding package that raises taxes may be challenging.

The Legislature should consider the Administration's proposal to increase the vehicle registration fee by \$10 to raise the amount of MVA funding generated for the ARB, CHP, and DMV, or alternative proposals to ensure solvency of the state's transportation system. In addition, the Legislature should consider enacting efficiency reforms to maximize the effectiveness of transportation funding.

# Mitigation Strategies to Reduce Transportation Costs

## BACKGROUND

Federal and state environmental laws require that restoration and conservation activities address the ecological impacts of infrastructure projects. Mitigation of these impacts on the natural environment can be a significant cost. A survey of selected state transportation departments suggests that the per project cost of environmental mitigation, ranges from two and 12 percent, averaging 7.5 percent of total project costs.

According to California's Five-Year Infrastructure Plan, the state plans to invest \$50.0 billion in the state's transportation system—which includes state highways, transit, and high-speed rail—over the next five years. Applying the estimated cost of environmental mitigation to the estimate of the state's transportation investments indicates the state could potentially spend between \$1.0 billion (two percent) and \$6.0 billion (12 percent) on mitigation over the next five years, as shown in the figure below.

**Potential Range of Environmental Mitigation Costs Based on Estimated State Transportation Infrastructure Expenditures  
(Dollars in Billions)**

	<b>Estimated Expenditures through 2020-21</b>	<b>Two Percent Mitigation Cost</b>	<b>Twelve Percent Mitigation Cost</b>
<b>Caltrans</b>	\$24.8	\$0.5	\$3.0
<b>High-Speed Rail</b>	\$25.2	\$0.5	\$3.0
<b>Total</b>	<b>\$50.0</b>	<b>\$1.0</b>	<b>\$6.0</b>

Mitigation addresses specific negative impacts from discrete infrastructure projects, and typically occurs concurrently, or after construction is completed. However, this approach can negatively impact overall conservation outcomes because it fails to consider regional impacts and the environment as a whole, sometimes resulting in isolated “mitigated islands” that are disconnected from natural ecosystems. In addition, traditional approaches to satisfying mitigation requirements have resulted in delays during the environmental review process, which can delay project delivery, potentially increasing total project costs. The California Department of Transportation (Caltrans) has estimated that as a result of cost overruns due to environmental reviews the state spends roughly \$59 million annually. Moreover, it can be costly and difficult to manage mitigation sites.

In contrast, to contemporaneous or after the fact efforts, advance mitigation is an approach where mitigation is constructed in advance of a permitted impact. For example, an advance mitigation site is planned, designed, permitted, and constructed before the completion of a transportation project that could use any of the mitigation credits generated by the site. Unlike other mitigation approaches, advance mitigation tends to be a collaborative effort that consists of proactive efforts to identify, fund, and compensate for future environmental impacts. Generally, the affected site must generate mitigation benefits for a certain period of time after the completion of construction to be eligible for mitigation credits.

### **Benefits of Advance Mitigation**

Advance mitigation can reduce infrastructure project costs and increase environmental benefits. A recent report by the University of California, Davis finds that advance mitigation could lead to potentially significant financial and staff time savings for Caltrans through the avoidance of mitigation costs, economies of scale achieved in mitigation expenditures, and avoided procedural costs and project delays related to permitting of future projects. The report estimates that the incidence and length of project delays due to environmental processes could be reduced by 10 percent, or a time savings of 1.3 months per project due to avoided delay.

The biggest potential savings of this approach may result when a land conservation purchase is made during a market slow-down when it otherwise would have been made at a market peak. Also, cost-savings potentially can be increased if the mitigation agencies can purchase larger tracts of land all at once. Larger sites may also result in more effective conservation because they provide a greater degree of ecological function. Large, more cohesive sites can result in reduced monitoring and management costs because of efficiencies in size.

In addition, advance mitigation removes some of the speculation about “how much” mitigation a certain approach will achieve. According to Caltrans, this can result in savings to the state and efficiencies because advance mitigation can show in advance of when mitigation credits are needed that a certain mitigation approach will have the desired results. Savings may occur because permitting agencies may require less mitigation than would otherwise be required.

As an example of the benefits of advance mitigation, North Carolina’s Department of Transportation (NCDOT) has used advance mitigation to achieve cost reductions and environmental benefits. Specifically, during the mid-1990s, NCDOT attributed up to 40 percent of new construction project delays to problems with wetland and stream requirements under the Clean Water Act. As a result, the agency was spending between \$40 and \$60 million per year on mitigation with project delays of 18 to 24 months due to negotiations over project-level impacts.

To address NCDOT permitting delays, the North Carolina Ecosystem Enhancement Program (EEP) was created in 2003 between NCDOT, North Carolina Department of Environment and Natural Resources, and the United States Army Corps of Engineers, the permitting agency. The parties agreed that a significant gain in operational efficiency could be achieved by combining the mitigation programs of NCDOT with those of the Wetlands Restoration Program. The objective was to use NCDOT’s future need for mitigation as a means to acquire and restore lands in advance of the impacts caused by the actual development of transportation infrastructure projects.

Under the EEP, mitigation is done programmatically for projects in North Carolina's seven-year State Transportation Improvement Program (STIP). Regulatory oversight of the EEP is conducted through quarterly and annual reports and inspections of all EEP mitigation sites to assure that the mitigation is achieving the intended outcomes.

The NCDOT funds mitigation in advance and thereby enables the EEP to produce mitigation prior to the impacts of transportation projects. Approximately 75 percent of the funding for EEP comes from NCDOT for mitigation of STIP projects. The remaining 25 percent comes from in-lieu fees from private development and other public agencies.

Since EEP has been implemented, no transportation projects have been delayed due to lack of available mitigation credits while more than \$5.4 billion in transportation-infrastructure improvements have been completed. Unexpectedly, the program has produced 4,000 acres of mitigation and tens of thousands feet of stream restoration—more mitigation than is estimated to be needed for projects under the seven-year STIP.

### **Limited California Efforts to Date, but Expansion Could Increase Benefits**

The Strategic Growth Council (SGC) within the Office of Planning and Research, along with individual departments, are considering, and modestly implementing advance mitigation. However, a more comprehensive, aggressive, and systematic approach on a statewide basis could increase advance mitigation's benefits to the state. These efforts include work being done at SGC, Caltrans, and the California High-Speed Rail Authority, as discussed below.

**Strategic Growth Council.** The SGC is leading an effort to coordinate state agencies for the development and implementation of an integrated approach to increase the efficiency and effectiveness of regional development and natural resource conservation. This effort is known as Integrated Regional Conservation and Development (IRCAD). The IRCAD is developing a framework and standard methodology for regional conservation assessments. The development of the framework will include a technology platform, and policy and financial strategies for departments to help ensure institutionalization and consistency.

Some of the challenges the SGC has faced include: determining how to best provide mitigation for infrastructure projects that range from discrete, small projects to much larger developments, such as the state's high-speed rail system; how to prospectively identify properties that will be need to be obtained for conservation efforts; and, developing statewide goals for conservation. Other challenges include how to balance achieving environmental and conservation goals with infill development.

The multi-agency effort includes representatives from Caltrans, California Department of Fish and Wildlife (CDFW), California Department of Conservation, California Department of Water Resources, California Energy Commission, California Department of Food and Agriculture, US Fish and Wildlife Service, UC Davis, and the Nature Conservancy.

Currently, five demonstration projects are being implemented with the intention of documenting the value of a regional approach, improving implementation efficiencies, and advancing regional conservation goals. Two of these projects are being carried out for high-speed rail sections in

Southern California and regional planning in the San Joaquin Valley. Additional projects are being evaluated in the central grasslands, the Sierra Nevada, and the San Francisco Bay Area.

**Caltrans.** In 2011, Caltrans signed an agreement with CDFW, U.S. Army Corps of Engineers, South Pacific Division, the U.S. Environmental Protection Agency, the U.S. Fish and Wildlife Service, and National Marine Fisheries Service to establish a mutual framework for coordinated review concerning the development of a statewide advance mitigation initiative for transportation projects. The concept was that the initiative could provide an option for Caltrans to leverage funds for timely mitigation acquisitions that could (1) reduce project delays, (2) reduce mitigation costs, and (3) improve mitigation quality.

As part of implementing advance mitigation, Caltrans has developed geospatial information tools to help estimate mitigation needs for the department, and identified new policies and barriers that it might need to address. In the fall of 2013, Caltrans established a \$5 million set-aside within its State Highway Operations and Protection Program (SHOPP) roadside preservation program that would be available for advance mitigation purposes beginning in 2016. In addition, Caltrans has developed initial planning documents for three such projects with an estimated cost of nearly \$11 million. In the 2015-16 budget, the Administration also proposed to implement an advance mitigation program to facilitate the purchase or construction of mitigation programs without the addition of new resources; it is unclear how this action is different from the work that was already underway at Caltrans.

One of the challenges that Caltrans has identified to establishing an effective advance mitigation program is the need to develop new mitigation banks. A conservation or mitigation bank is privately or publicly owned land managed for its natural resource values. In exchange for permanently protecting, managing, and monitoring the land, the bank operator is allowed to sell or transfer habitat credits to project proponents who need to satisfy legal requirements for mitigating the environmental impacts of projects. New banks could potentially be more effective than existing banks by helping to address mitigation for a broader range of animal and plant species and meet the requirements of many permitting agencies. For example, a multispecies conservation program could be implemented to protect and preserve sensitive plant and animal species and interconnected areas. Development of such banks might require an increase in staff at various state natural resources permitting agencies.

Obtaining funding for advance mitigation can be a challenge because the mitigation site must be constructed several years before funding for the transportation project is available. To address this challenge, Washington State established a specific revolving fund so that projects may obtain funding for early mitigation work. Similarly, SB 34/8x (Padilla), Chapter 9, Statutes of 2010, was enacted to facilitate project mitigation actions for certain proposed renewable energy projects in the California desert. The program was implemented through use of a \$10 million dollar revolving fund established by SB 34 (the Renewable Energy Resources Fund), with expenditures to be reimbursed from the participating projects' mitigation fees.

Another challenge for Caltrans is that the four-year life cycle of the SHOPP makes it difficult to plan and complete mitigation projects in advance because mitigation and construction may be funded in two different cycles. Moreover, it will take a cultural shift (and related shift in how

districts are staffed) at Caltrans to effectively move towards completing mitigation in advance, rather than at the end of a project. Finally, developing an approach that complies with federal requirements to ensure the state receives maximum federal reimbursements would be important. As an innovative example, Caltrans is trying to find a way to have fish passage remediation projects (programmed through the SHOPP) count as credits/value for advance mitigation.

The California Transportation Commission has expressed its support of Caltrans using advance mitigation and recommends in its 2015 annual report that the Legislature authorize the Administration to implement an “advanced mitigation” environmental program, including approving an up-front environmental mitigation program funding set-aside.

**High-Speed Rail.** Regional advance mitigation planning (RAMP) is being considered for the high-speed rail project. A goal of the RAMP approach is to anticipate mitigation requirements early in the project planning and environmental review process, before the projects are in the final stages of approval. Such an approach can result in a more efficient and effective planning process. Because high-speed rail is a long-term and statewide project, it is potentially well-suited to this approach and such an approach would help to ensure that environmental mitigation obligations do not slow down the project.

According to high-speed rail staff, for the Merced to Fresno portion of the project there are approximately 1,200 commitments to conduct mitigation. Regarding these commitments, work needs to be completed in order to determine who is responsible for fulfilling these environmental commitments. Responsibilities could lie with the state, contractors, local partners, or some combination thereof. In addition, resources’ permitting agencies need to clarify what mitigation measures are necessary.

### **Some Locals Have Implemented a Regional Approach to Advance Mitigation**

The San Diego Association of Governments (SANDAG) is the planning HSRA for the San Diego Region. In 2008, SANDAG began to consider, in the context of mitigation, ways to address factors such as housing, transportation, and the environment in one planning document. The SANDAG’s goal was to ensure that mitigation efforts are aligned with the regional vision for integrated land use and transportation, as well as the local jurisdiction’s land use objectives. The program established an inventory of baseline data to measure the progress in meeting the objectives and implemented an annual monitoring plan. The \$850 million program began purchasing property in 2008 and has now acquired nearly 3,800 acres around the region at a cost of \$121.8 million. Land purchases are done according to targets set in regional habitat conservation plans. In addition, several mitigation banks have been established to offset potential impacts from road projects. Orange County also uses a regional approach to advance mitigation and a similar approach is being considered for the San Francisco Bay Area.

## **GOVERNOR’S PROPOSAL**

The budget proposes \$30 million for advance mitigation for Caltrans. This funding is provided as part of its transportation funding reform measures included in the Administration’s plan for increased transportation funding. No specific details are provided describing how this funding will be used.

**ISSUES TO CONSIDER**

Any consideration of increasing the amount of funding available to meet the state's transportation needs should examine whether the existing level of funding is being used as efficiently as possible, and what can be done to maximize existing resources. One approach that has been considered, but not fully implemented in California, is advance mitigation. California's Five-Year Infrastructure Plan proposes to spend \$50.0 billion on highway and high-speed rail projects over the next five years. It is estimated that mitigation costs for these projects may range from between \$1.0 billion and \$6.0 billion. Reducing the costs of mitigation expenditures would have the effect of freeing up money for transportation projects.

Advance mitigation raises many issues that the Legislature may wish to evaluate or address through a pilot project or other legislation. These issues include:

- Measuring the potential amount of cost savings from advance mitigation. This can be challenging to calculate because of limited or missing data and the difficulty of assessing what would have happened in the absence of such expenditures.
- How much funding should be set aside for advance mitigation projects at Caltrans?
- How to establish statewide mitigation banks and implement a regional, rather than project-specific, mitigation approach.
- How to develop the best framework for advance mitigation. Such a framework might consider how to change departmental cultures and implement a consistent and cohesive approach statewide and across affected departments.
- The need and potential funding sources for additional staff and resources at both the transportation-related departments and the resources' permitting agencies.
- Ensuring the implementation of an advance mitigation approach aligns with federal reimbursement requirements.
- How to balance the risks and benefits of implementing a program to do large-scale, large-impact mitigation efforts for the high-speed rail project, with the uncertainty about the available future funding to complete the project.
- The role of the SGC and individual departments and how to empower the SGC to effectively implement a statewide approach.

# High-Speed Rail: Strategies for Project Success

## 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 21<sup>st</sup> 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 combined \$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, the 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.

### Project Making Progress

The implementation of the high-speed rail project continues to move forward, although with some delays not unexpected with a project of this magnitude and complexity. 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 revenues, or Greenhouse Gas Reduction Funds, for the project. As a result, the project faces fewer funding hurdles related to construction of the initial segments. However, there is still a shortfall of tens of billions of dollars to complete the initial operating segment (IOS) which spans 300 miles from Merced to the San Fernando Valley. 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. Yet, significant construction has been delayed due to the acquisition of right-of-way properties taking much longer than anticipated. The alignment of the IOS and the proposed phases of the project are shown on the map below.

Proposed Alignment of California’s High-Speed Rail System



Source: High-Speed Rail Authority

**Request for Expressions of Interest**

On June 22, 2015, the HSRA issued a request for expressions of interest (RFEI) from potential private sector partners. Private sector participation is critical for financing, construction, and operation of the project because of the size, cost, and complexity of the project. The financing is especially important, given that the use of Proposition 1A bond funds has been tied up in legal challenges, additional federal funds are unlikely to be forthcoming, and, at this time, cap-and-

trade revenues after 2020 are uncertain because, under the current law, the program that generates this revenue terminates at this time.

Specifically, the request asked various questions to identify what roles the private sector might be willing to play as a partner in the construction, financing, and operation of the IOS. The Authority received 36 responses from various entities including AECOM, China Railway International, Fluor/Balfour Beatty, Siemens, Barclays, and Parsons.

### **Peer Review Group Evaluation**

The High-Speed Rail Peer Review Group (PRG), which consists of eight members, provides external oversight of the high-speed rail project for the Legislature. Recently, the PRG reviewed the responses to the RFEI. Based on these responses, the PRG determined that significant private sector participation in the project is related to three factors.

- First, potential private sector partners will not take consumer demand or associated revenue risks until such demand has been demonstrated for a significant section of the system. Instead, these partners would likely require an “availability payment” where the HSRA guarantees a certain level of revenue to a private partner until the ridership demand actually results in that level of revenue. Since demand cannot effectively be demonstrated until 2025, when the initial operating system is completed, according to the PRG, availability payments would be required until then. Such a payment could conflict with the requirement in Proposition 1A that prohibits any operating subsidy.
- Second, the project has significant financing risks because nearly all of its funding sources are uncertain. Specifically, the use of Proposition 1A funding for the project is currently being litigated which has prevented it from being fully available. Most of the federal funds must be spent by September 30, 2017 and project delays may prevent this from happening, and it is unlikely that the expenditure of these funds could be extended. Moreover, it is unlikely that additional federal funds will be available in the near future. Finally, the cap-and-trade program has not been extended beyond 2020 and the amount of funding available annually from this source is estimated to be only about \$500 million.
- Third, the potential partners raised concerns about the structure for delivering the project. Specifically, the private sector raised concerns about the lack of a coordinating partner for delivery of the project. While, such a contractor could be brought on to provide coordination, doing so would require a shift in roles from the existing contractors to new contractors. According to the PRG, “this could conflict with the way the project is currently structured and managed and could even now be difficult because the integration of the work and design commitments already made might pose risks to a new partner.”

The PRG states that the private sector in its responses clearly highlights a major (but not new) issue the project faces—“the known sources of funding will need to be modified if the authority is able to manage the risks and potential financial demands that the project faces.”

### 2016 Business Plan

State law requires the HSRA to submit a business plan to the Legislature every two years. The first plan was submitted in 2012, the most recent plan in April 2014, and the next plan will be submitted in 2016. The plan must include a description of the project, the schedule of environmental review and construction, cost estimates, forecasted patronage, service levels, and operating and maintenance costs, alternative financial scenarios, anticipated funding, information regarding public-private partnership strategies, and a discussion of project risks. According to the PRG, it will be critical that the 2016 business plan identifies and carefully evaluates the options for moving ahead in light of the challenges it raised in its review of the RFEIs.

## GOVERNOR'S PROPOSAL

The budget for 2016-17 provides a total of \$1.8 billion (\$1.1 billion for local projects) for the high-speed rail system as shown in the figure below. In addition, the budget requests the reappropriation of \$145.2 million that was originally appropriated by the Legislature in 2012-13 and also proposes \$826,000 in Proposition 1A bond funds for six auditor positions to perform audits of contract costs that have been billed and reimbursed, and to perform audits the HSRA's Board of Directors has requested.

### High-Speed Rail Expenditures (Dollars in Millions)

Funding Source	2014-15	2015-16	2016-17
<b>Capital Outlay</b>			
Proposition 1A	\$1,087.1	\$228.0	\$11.4
Federal funds	840.5	28.0	0.0
Greenhouse Gas Reduction Fund	250.0	600.0	600.0
Subtotal capital outlay	2,177.6	856.0	611.4
<b>Local Assistance</b>			
Local projects	0	0	1,100.0
<b>State Operations</b>			
Various state funds	28.3	41.4	42.3
<b>Total</b>	<b>\$2,205.0</b>	<b>\$897.4</b>	<b>\$1,753.7</b>

## ISSUES TO CONSIDER

### Strategies for High-Speed Rail

The PRG's recent letter highlights important issues the Administration and the Legislature should address to best ensure the successful delivery of the high-speed rail project. Specifically, the PRG discusses the importance of the state securing future cap-and-trade revenues for the project, the concern of potential private partners that the project has the full faith and credit of the state behind it before they will invest in it, the importance of the structure of the project's delivery, and the need for strong oversight of the project. In its letter, the PRG raises several issues the Legislature may want to consider as it reviews the 2016 business plan for the high-speed rail project:

- Should the Legislature back the HSRA and the project with the full faith and credit of the state?
- Should the cap-and-trade program be extended beyond 2020 and a greater percentage of cap-and-trade revenues (currently 25 percent) be continuously appropriated to the project? Should actions be taken so that this stream of revenue can be securitized?
- Should the state consider applying for federal loans for the project that would need to be repaid with state funds?
- Is the current oversight of the project adequate? (This topic was more fully explored in the Senate's *Overview of the 2015-16 Budget Bill*.) Should the Legislature create a focused committee dedicated to oversight and staffed by individuals that can provide long-term oversight of the project (such as the Legislative Analyst's Office)?

In addition, to considering the adequacy of funding and oversight of the project the Legislature may want to examine the adequacy of the project management structure and ask HSRA the following questions:

- What is the appropriate size (dollar value) construction project to award to contractors and what size project can HSRA staff and contractors effectively oversee?
- What is HSRA doing to ensure that integration and compatibility conflicts are not created when awarding, for example, track and electrical contracts to one vendor, and a contract for designing rolling stock (trains) to another vendor?
- Overall, what steps are being taken to minimize the risks of using numerous different contractors to deliver the project?

# SUBCOMMITTEE NO. 3

## HEALTH and HUMAN SERVICES

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## Medi-Cal: Coordinated Care Initiative

### BACKGROUND

The Department of Health Care Services administers the Medi-Cal program (California's Medicaid health care program). This program pays for a variety of medical services for children and adults with limited income and resources.

The Governor proposes total expenditures of \$85.1 billion (\$19.1 billion General Fund) for 2016-17. This is an eight percent increase in General Fund spending from the prior year. It is projected that Medi-Cal will serve about 13.5 million Medi-Cal eligible individuals (about 5.1 million children), an increase in caseload of about 1.5 percent, primarily due to the implementation of federal health care reform under the Affordable Care Act (ACA). It is estimated that over a third of the state's total population will be enrolled in Medi-Cal.

Medi-Cal offers free or low-cost health coverage for California residents who meet eligibility requirements. Most applicants who apply through Covered California and enroll in Medi-Cal will receive care through managed health plans. Medi-Cal has always covered low-income children, pregnant women and families. On January 1, 2014, California expanded Medi-Cal eligibility to include other low-income adults.

**Coordinated Care Initiative Background.** The 2012 budget authorized the Coordinated Care Initiative<sup>1</sup> (CCI), which expanded the number of Medi-Cal enrollees who must enroll in Medi-Cal managed care to receive their benefits. Under the current memorandum of understanding with Centers for Medicare and Medicaid Services (CMS), Cal MediConnect ends on December 31, 2017. The Administration has indicated to CMS that it is interested in extending this date (as allowed by CMS) but has not committed to an extension. The CCI is being implemented in seven counties<sup>2</sup> (Los Angeles, Orange, 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.

<sup>1</sup> 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.

<sup>2</sup> Alameda County was initially part of CCI but due to fiscal solvency issues with one of its plans, it will not participate in CCI.

- **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 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.

**Cal MediConnect Enrollment Summary, as of December 1, 2015**

County	Enrollment
Los Angeles	44,655
Orange	4,354
Riverside	13,813
San Bernardino	13,718
San Diego	16,442
San Mateo	9,684
Santa Clara	13,077
<b>Total</b>	<b>115,743</b>

**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. San Mateo County transitioned to the Statewide Authority in February 2015; Los Angeles, Riverside, San Bernardino and San Diego counties in July 2015; Santa Clara County in January 2016 and finally Orange County is anticipated 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.

**Requirements on 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.

## GOVERNOR'S PROPOSAL

**Coordinated Care Initiative.** The budget continues to implement CCI in 2016. The Administration states that it will seek ways to improve participation in the program and extend an allowable managed care organization (MCO) tax. If the MCO tax is not extended and participation is not improved by January 2017, the Administration states that CCI would cease operating effective January 2018. See table below for a CCI funding summary.

Coordinated Care Initiative Funding Summary				
January 10, 2016				
	FY 2015-16		FY 2016-17	
(In thousands)	Total Fund	General Fund	Total Fund	General Fund
<b>SAVINGS</b>				
<b>Local Assistance Costs (Savings)</b>	<b>\$ 3,105,446</b>	<b>\$ 437,970</b>	<b>\$ 2,602,495</b>	<b>\$ 104,449</b>
Payments to Managed Care Plans	\$ 9,889,062	\$ 4,944,531	\$ 10,319,468	\$ 5,159,734
Transfer of IHSS Costs to DHCS	\$ -	\$ (1,114,753)	\$ -	\$ (1,196,798)
Savings from Reduced FFS Utilization	\$ (6,783,616)	\$ (3,391,808)	\$ (7,716,973)	\$ (3,858,487)
<b>Payment Deferrals</b>	<b>\$ (151,439)</b>	<b>\$ (75,719)</b>	<b>\$ 8,580</b>	<b>\$ 4,290</b>
Defer Managed Care Payment	\$ (175,840)	\$ (87,920)	\$ 1,708	\$ 854
Delay 1 Checkwrite	\$ 24,401	\$ 12,201	\$ 6,872	\$ 3,436
<b>Revenue</b>	<b>\$ (561,516)</b>	<b>\$ (561,516)</b>	<b>\$ (155,628)</b>	<b>\$ (155,628)</b>
Current Law: MCO Tax from Increasing Managed Care Enrollment Due to CCI	\$ (175,392)	\$ (175,392)	\$ (48,483)	\$ (48,483)
Current Law: Incremental MCO Tax from non-CCI	\$ (386,124)	\$ (386,124)	\$ (107,145)	\$ (107,145)
<b>Retro MC Adjustments</b>	<b>\$ 198,881</b>	<b>\$ (18,060)</b>	<b>\$ (428,219)</b>	<b>\$ (214,110)</b>
CCI Rates Recasting	\$ 198,881	\$ (18,060)	\$ (428,219)	\$ (214,110)
<b>Savings Sub-Total</b>	<b>\$ 2,591,372</b>	<b>\$ (217,325)</b>	<b>\$ 2,027,228</b>	<b>\$ (260,999)</b>
<b>COSTS</b>				
<b>Increased DHCS Costs</b>				
Administrative Costs	\$ 29,062	\$ 14,405	\$ 19,823	\$ 9,912
<b>Increased DSS Costs</b>				
Service Costs (increased GF due to MOE)	\$ 383,098	\$ 383,098	\$ 375,875	\$ 375,875
DSS Administrative Costs from CCI	\$ 7,893	\$ 3,959	\$ 7,893	\$ 3,959
<b>CalHR Administrative Costs</b>	<b>\$ 1,921</b>	<b>\$ 961</b>	<b>\$ 1,921</b>	<b>\$ 961</b>
<b>DMHC Administrative Costs</b>	<b>\$ 2,186</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>CDA Administrative Costs</b>	<b>\$ 281</b>	<b>\$ -</b>	<b>\$ 281</b>	<b>\$ -</b>
<b>Costs Sub-Total</b>	<b>\$ 424,441</b>	<b>\$ 402,423</b>	<b>\$ 405,793</b>	<b>\$ 390,707</b>
<b>Net Impact to CA - Costs</b>	<b>\$ 3,015,813</b>	<b>\$ 185,098</b>	<b>\$ 2,433,021</b>	<b>\$ 129,708</b>
<b>Proposed MCO Tax Attributable to CCI</b>			<b>\$ (321,569)</b>	<b>\$ (321,569)</b>
<b>Net Impact to State with MCO Extension</b>			<b>\$ 2,111,452</b>	<b>\$ (191,861)</b>

**Managed Care Organization Tax.** The state's current managed care organization tax (MCO) offsets about \$1 billion expenditures annually and is effective through June 20, 2016. Last year, in response to updated federal guidance on the design of these types of taxes, the Governor proposed an extension of a revised version of this tax; however, the Legislature did not approve the Administration's proposal. The Governor called a special session to address the extension of this tax (and discuss rate increases for providers of Medi-Cal and developmental disability services).

The budget proposes a new tax reform package to extend the MCO. This new tax reform package now includes reforms in the gross premiums tax and corporation tax, which were not previously part of the proposal. As a result, this tax reform package reduces the tax liability for the health plan industry.

The new proposal nets about \$1.35 billion in tax revenue for the state, which would be deposited into a special fund. The Administration proposes to use \$236 million of this revenue to restore the seven percent reduction to In-Home Supportive Services. The remaining tax revenue (about \$1.1 billion) is unallocated and in the special fund reserve. The Administration notes its expectation that any additional targeted rate increases for services and supports to persons with developmental disabilities (above what is proposed in the budget) would be funded by the MCO revenue.

**Universal Assessment Tool.** The California Department of Social Services is requesting two three-year limited-term positions totaling \$232,000 (\$117,000 General Fund) to ensure the state's ability to address an increased workload of the Case Management, Information and Payroll System (CMIPS) project for the Universal Assessment Tool (UAT). These staff are intended to support the development of policy, coordinate stakeholder workgroups, and design, test, train, and implement the UAT.

## ISSUES TO CONSIDER

**Link to MCO Is Meaningless to the Goals of CCI.** The Administration has identified several factors that have occurred since the 2012 enactment of CCI that may jeopardize the fiscal solvency of this initiative. These factors included: (1) higher than expected opt-out rate; (2) higher IHSS fiscal exposure for the state as a result of the federal Fair Labor Standards Act (CCI established a maintenance-of-effort funding formula for IHSS); and, (3) the recent federal guidance on the MCO tax. If the MCO tax is not extended and participation is not improved by January 2017, the Administration states that CCI would cease operating effective January 2018.

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<sup>3</sup> and there are modest

<sup>3</sup> 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

increases in General Fund costs, it may be worthwhile to continue CCI. Unfortunately, as described in more detail below, data to evaluate CCI's impact on improved health outcomes and quality is not yet available.

**While Survey Data Shows Cal MediConnect Enrollees Are Satisfied.** Data from a Rapid Cycle Polling Project<sup>4</sup> shows that a majority of Cal MediConnect enrollees are satisfied with the choice of doctors they can see and the level of care they receive. Seventy-eight percent of Cal MediConnect enrollees surveyed are satisfied with their choice of doctors, and felt the same about the way their different health care providers work together to give them the services they need. Seventy-nine percent of enrollees also felt confident that they can get their questions answered about their health needs.

**Data Showing Changes In Health Care Quality or Outcomes Not Available.** While consumer satisfaction is an important component in evaluating the success of Cal MediConnect, data showing 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 is not available. It appears that DHCS has not made any substantial progress, compared to last year, in getting access from the federal CMS to this data.

**No Understanding of How MLTSS Has Impacted Health Care Quality or Outcomes.** As described above, CCI includes the addition of MLTSS into Medi-Cal managed care. This change impacts over one million individuals on Medi-Cal. Data impacting this population is available to DHCS and is not "owned" by CMS. However, DHCS has not conducted any consumer satisfaction surveys or analyzed data to understand how this component of CCI is changing health outcomes and consumer experiences.

**Consumer Protections Must Be Ensured In Any Changes To Enrollment Policies.** In an effort to increase enrollment into Cal MediConnect, DHCS indicates that it plans to work with health plans on streamlining the enrollment process. Details on what this may include are not yet available; however, it is important that any simplification of enrollment not dismantle protections in place to ensure that the consumer makes an independent and uncoerced decision.

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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.

<sup>4</sup> This project is a result of a partnership between The SCAN Foundation; DHCS; Field Research Group Corporation; Community Living Policy Center at the University of California (UC), San Francisco; and the UC Berkeley Health Research for Action Center.

# Medi-Cal: Home and Community Based Services

## BACKGROUND

California's Medi-Cal Home and Community-Based Services (HCBS) programs are designed to offer safe and appropriate home and community-based care to individuals in lieu of long-term institutional placement. These programs serve about 500,000 individuals and are implemented by various state departments including the Department of Health Care Services (DHCS), the Department of Developmental Services (DDS), the California Department of Aging (CDA), and the California Department of Public Health (DPH). The state receives almost \$7 billion annually in federal funds for these programs.

California's HCBS programs are implemented through the following:

- **1915(c) Waivers.** The federal government authorized the "Medicaid 1915(c) Home and Community-Based Services Waiver program" in 1981. The original intent of the HCBS Waiver program was to slow the growth of Medicaid (Medi-Cal in California) spending by providing services in less expensive settings. In order to contain costs, the federal legislation limited waiver services to individuals who would be institutionalized if the services were not provided. However, the costs of those waiver services cannot be higher than what they would cost in an institutional setting.

The law permitted states to waive certain Medicaid program requirements and in doing so, deviate from Medicaid requirements, such as providing services only in certain geographic areas ("waive statewideness"). The HCBS Waiver program also allowed states flexibility to offer different types of services to individuals with chronic disabilities. Prior to this, with the origin of Medicaid in 1965, beneficiaries could only receive comprehensive long-term care in institutional settings.

The waiver can be designed for a variety of targeted diagnosis-based groups including individuals who are elderly, and those who have physical, developmental, or mental health disabilities, or other chronic conditions such as Human Immunodeficiency Virus/Acquired Immunodeficiency Syndrome (HIV/AIDS). The waiver can be designed to offer a variety of services including case management, personal attendant services, adult day health care services, habilitation services, day treatment services, psychosocial rehabilitation services, mental health services, and other services specifically requested by the state. 1915(c) HCBS waivers have subsequently become mechanisms for many states, including California, to provide Medicaid-funded community-based, long-term care services and supports to eligible beneficiaries.

California's 1915(c) HCBS waiver programs are:

- **Multipurpose Senior Services Program (MSSP) Waiver** (administered by CDA). The objective of this program is to provide opportunities for frail seniors age 65 or older to maintain their independence and dignity in community settings by preventing or delaying avoidable nursing facility placement. There are about 12,000 participants in this program.
- **HIV/AIDS Waiver** (administered by DPH). The purpose of this waiver is to allow persons of all age with mid- to late-stage HIV/AIDS to remain in their homes through a continuum of care designed to stabilize and maintain an optimal level of health, improve quality of life, and provide an alternative to institutional care in hospitals or nursing facilities. There are about 3,200 participants in this program.
- **Developmental Disabilities (DD) Waiver** (administered by DDS). The purpose of this waiver is to serve beneficiaries of all ages in their own homes and community settings as an alternative to placement in hospitals, nursing facilities or intermediate care facilities for persons with developmental disabilities (ICF-DDs). There are about 150,000 participants in this program.
- **Assisted Living Waiver (ALW)** (administered by DHCS). This waiver offers eligible seniors and persons with disabilities age 21 and over the choice of residing in either a licensed Residential Care Facility for the Elderly or an independent publicly subsidized housing with Home Health Agency services as alternatives to long-term institutional placement. There are about 4,000 participants in this program.
- **Nursing Facility/Acute Hospital (NF/AH) Waiver** (administered by DHCS). This waiver offers services in the home to Medi-Cal beneficiaries with long-term medical conditions, who meet the acute hospital, adult subacute, pediatric subacute, ICF-DD-continuous nursing, and nursing facility A/B levels of care with the option of returning and/or remaining in their home or home-like setting in the community in lieu of institutionalization. There are about 3,500 participants in this program.
- **In-Home Operations (IHO) Wavier** (DHCS). This waiver was originally developed for those individuals who had been continuously enrolled in a DHCS administered waiver prior to January 1, 2002 and who primarily receive direct services rendered by a licensed nurse. This waiver offers services to Medi-Cal beneficiaries with long-term medical conditions in their home or a home-like setting in the community in lieu of institutionalization. There are about 125 participants in this program.
- **San Francisco Community Living Support Benefit (SFCLSB) Waiver** (administered by San Francisco Department of Public Health). This waiver utilizes certified public expenditures for provision of waiver services to persons with disabilities age 21 and over who reside in the City or County of San Francisco and who are either homeless, residing in a nursing facility, or are at imminent risk of entering a nursing facility. There are about 17 participants in this program.

- **Pediatric Palliative Care (PPC) Waiver** (administered by DHCS). This waiver offers children with life limiting conditions a range of home-based hospice-like services while they maintain the option of receiving curative treatment. There are about 1,800 participants in this program.
- **1115 Waiver - Community-Based Adult Services (CBAS)**. CBAS offers center-based services to eligible older adults and/or adults with disabilities to restore or maintain their optimal capacity for self-care and delay or prevent inappropriate or personally undesirable institutionalization. There are about 32,000 participants in this program.
- **1915(i) State Plan Program**. Starting January 1, 2007, the Deficit Reduction Act of 2005 (DRA) gave states a new option to provide HCBS through their state plans. Once approved by the Centers for Medicare and Medicaid Services (CMS), state plans do not need to be renewed nor are they subject to some of the same requirements of waivers. Under this option, states set their own eligibility or needs-based criteria for providing HCBS. States are allowed to establish functional criteria in relation to certain services. The DRA provision eliminated the skilled need requirement and allowed states to cover Medicaid beneficiaries who have incomes no greater than 150 percent of the federal poverty level and who satisfy the needs-based criteria. The Patient Protection and Affordable Care Act of 2010 created several amendments including elimination of enrollment ceilings, a requirement that services must be provided statewide, and other enrollment changes.

California currently has an approved 1915(i) State Plan program that allows the state to access federal financial participation for services provided to individuals with developmental disabilities who do not meet the institutional level-of-care criteria required for participation in the 1915(c) HCBS DD Waiver. There are about 32,000 participants in this program.

- **1915(k) Community First Choice (CFC) State Plan Program - IHSS**. This program provides IHSS services to individuals who meet a nursing facility level of care and allows an individual to live safely in his/her own home. CFC-IHSS services are provided in consumer-controlled homes. By being in the community and self-directing care, the individual is able to control their environment to the maximum extent consistent with their capabilities and needs. There are about 220,000 participants in this program.

**New Home and Community-Based Setting Requirements.** In January 2014, CMS announced it had finalized important rules that affect HCBS waiver programs and 1915(i) state plan programs provided through Medicaid/Medi-Cal, and subsequently published regulations in the Federal Register on January 16, 2014. The rules became effective 60 days from publication, or March 17, 2014. The state must fully comply with these rules by March 17, 2019. If the state does not comply with these rules it would be at risk of losing federal funds.

The purpose of the final rule is to ensure that individuals receive HCBS in settings that are integrated in and support full access to the greater community. The final rule also aims to ensure that individuals have a free choice of where they live and who provides services to them, and that individual rights and freedoms are not restricted, among other provisions.

Prior to the final rule, home and community-based (HCB) setting requirements were based on location, geography, or physical characteristics. The final rule defines HCB settings as more process and outcome-oriented, guided by the consumer's person-centered service plan by:

- Being integrated in and supporting full access to the greater community, including opportunities to seek employment and work in competitive integrated settings, engage in community life, control personal resources, and receive services in the community, to the same degree of access as individuals not receiving Medicaid HCBS.
- Giving individuals the right to select from among various setting options, including non-disability specific settings and an option for a private unit in a residential setting.
- Ensuring individuals' rights of privacy, dignity and respect, and freedom from coercion and restraint.
- Optimizing autonomy and independence in making life choices, including daily activities, physical environment and with whom to interact.
- Facilitating choice regarding services and supports, and who provides them.

For Medicaid/Medi-Cal provider-owned or controlled HCB residential settings, the provider must offer:

- A legally enforceable agreement between the provider and the consumer that allows the consumer to own, rent or occupy the residence and provides protection against eviction.
- Privacy in units including lockable doors, choice of roommates and freedom to furnish and decorate units.
- Options for individuals to control their own schedules including access to food at any time.
- Individual's freedom to have visitors at any time.
- A physically accessible setting.

**DHCS Lead State Agency.** DHCS acts as the Single State Medicaid Agency for the 1915(c) and 1115 waivers and 1915(i) and 1915(k) state plan programs. DHCS as the Single State Medicaid Agency is responsible for the funding and administration, monitoring and oversight for all of the HCBS programs. DHCS has taken the lead role to ensure all affected departments, programs, and their providers are aware of and collaborate with DHCS to come into compliance with the new federal HCBS setting final rule. On December 19, 2014 and again on August 14, 2015, DHCS submitted its "Statewide Transition Plan (STP) for Compliance with Home and Community Based Settings Rules" to CMS.

In the STP, DHCS highlights the various phases of implementation the state has taken and will take to achieve compliance with the HCB settings requirements:

- Education and Outreach. Information and education on the requirements of the HCB settings requirements and the regulations will be provided to state departments, consumers and families, regional centers, providers, advocacy groups, and other interested stakeholders on an ongoing basis.
- Systematic Assessment of Statutes, Regulations, Policies, and Other Requirements. DHCS and the other state departments have reviewed statutes, regulations, policies, and other requirements for residential and nonresidential HCB settings to determine the extent to which the state's standards comply with federal regulations. Stakeholders participated in and provided input to most aspects of this process.
- Compliance Determination Process for HCB Settings. An initial sample of on-site assessments will be completed as part of the existing monitoring and oversight processes and further on-site assessments will be conducted based on provider/beneficiary self-surveys. The final list of settings to have an on-site assessment will be completed and reported with timeframes for completion of on-site assessments and a plan for bringing sites into compliance as needed.
- Role of Person-Centered Planning. The impacted state departments will use a stakeholder process to evaluate the role of person-centered planning, as it relates to determining compliance with the federal regulations, assessing consumer satisfaction with the setting options, and other possible community integration issues.
- Appeal Process. The state will research existing appeals processes and determine the feasibility of incorporating the HCB setting appeal and complaint process into current structures.
- Compliance Monitoring. Each program will use self-surveys, on-site assessments, and/or other data collection methods to develop remedial strategies and monitor progress toward compliance with the federal regulations.
- Plan Updates and CMS Reporting. Progress on the STP will be continuously monitored and reported to CMS, as needed.

**GOVERNOR’S PROPOSAL**

**DHCS Budget Proposal.** DHCS requests limited-term resources of \$1,112,000 (\$491,000 General Fund and \$621,000 Federal Trust Fund) for the following:

- Three-year limited-term resources to comply with HCBS Final Rule, described above.
- Four-year limited-term resources to work on the ALW program, coordinate activities with the STP, and ensure ongoing compliance of ALW providers with the HCBS Final Rule. Resources will also address continued work to meet existing CBAS workload, coordinate activities with the STP, and ensure ongoing compliance of CBAS providers with the HCBS Final Rule. The resources will address work done currently by limited-term positions that are set to expire June 30, 2016.

DHCS proposes the following timeline to comply with the new HCBS rules:

<b>2014 THROUGH 2019</b>	<b>START</b>	<b>FINISH</b>
CMS Rules Implemented	-----	03/17/2014
STP Drafted and Reviewed by CMS	09/2014	03/2015
STP Revised with CMS Approval	03/2015	08/2015
Stakeholder & Public Meeting Input	09/2014	12/31/2018
Develop, Review, Approval & Publication of On-Site Assessment	05/2014	08/2015
Develop, Review, Approval, & Publication of Provider Self-Assessment Survey	07/2014	12/2016
Develop Review, Approval, & Publication of Beneficiary Assessment Survey	09/2015	12/2015
Develop, Review, Approval, & Publication of Setting Analysis & Remedial Action Timeline	05/2015	12/2016
On-site Evaluations and Assessments	07/2015	12/2018
Assessment of Statutes, Regulations, Policies	07/2014	08/2015
Survey Team Training	06/2015	12/2015
Collect Assessment Data	01/2016	03/2018
Develop & Implement Tracking Database System	07/2015	02/2019
Enter Data into Tracking System	07/2015	12/2018
Provide Data Reports of Outcome	07/2017	12/2018
Develop, Review, Approve and Implement a Complaint and Appeals Process	06/2015	02/2019
Conduct Remedial & Action Strategies	01/2018	12/2018
Provide Final Report to CMS	09/2018	02/2019
Monitoring and Oversight of Compliance	03/2019	6/30/2019

**DDS Budget Proposals.** The DDS budget includes \$15 million (\$11 million General Fund) for targeted rate increases to providers who will transition services, like segregated day programs and sheltered workshops, to models that are more integrated and consistent with the HCBS Waiver requirements. Additionally, the DDS budget proposes \$483,000 million (\$330,000 General Fund) and four positions to accommodate increased workload associated with complying with the HCBS waiver regulations. The new, comprehensive regulations create additional workload for planning, training, assessing, and reporting activities to demonstrate compliance by March 2019 in order for the state to maintain \$1.7 billion annually in federal financial participation reimbursements for Purchase-of-Services expenditures.

**CDA Budget Proposal.** CDA requests an augmentation of \$705,000 in funding (\$319,000 General Fund) for four additional positions needed to ensure compliance with current state Medical program requirements related to the 1115 Waiver and the HCBS setting rule.

## ISSUES TO CONSIDER

**CMS Has Not Yet Approved State's Transition Plan.** On November 16, 2015, CMS sent a letter to DHCS indicating that further information regarding, among other things, the settings impacted by the new HCBS rule, the timelines for many of the milestones outlined within the STP, and the state's plan for relocating beneficiaries, if needed. Additionally, CMS noted that:

*The state has omitted from the STP several key details about the site-specific assessment process including: when provider self-surveys will be completed, how the state will ensure responses from providers, how beneficiary surveys will be matched to provider assessments, how beneficiary and provider surveys will be used to identify settings that require on-site assessment, an estimate of the number of on-site assessments, how the state will ensure coordination across on-site assessments, and how the on-site assessment tool would be used to categorize compliant and non-compliant settings.*

It will be important for DHCS to continue to engage with providers and consumers on defining the outstanding process details to address CMS's concerns and get approval of the STP.

**Coordinated Statewide Approach is Critical.** The new federal rules are based on important principals that individuals have a free choice of where they live and who provides services to them, and that individual rights and freedoms are not restricted. It is critical that these principles are implemented consistently across the state's programs and agencies. It is DHCS's responsibility as the Single State Medicaid Agency to oversee this implementation and that it lead other departments in strategies to ensure compliance by 2019.

**Consumer and Provider Education is Essential.** Concerns have been raised by providers that the state has not provided sufficient direction on how these new federal rules may impact the various types of providers. While the state is still awaiting direction from CMS, it is essential that state departments, under DHCS's direction, communicate as soon as possible what needs to change and the processes that will be developed to measure and ensure compliance with the new HCBS rule. Clear guidance on what is needed to come into compliance and the state's

commitment of resources to support programs to move towards compliance is essential to successful implementation of this new rule.

**Questions for the Legislature to Consider.** The Legislature may wish to consider the following questions as it evaluates the proposals related to the HCB setting rule:

- Is the state prioritizing its assessment of HCBS programs and settings? If so, what criteria is it using (e.g., maximization of federal financial participation)?
- How is DHCS ensuring a coordinated and consistent statewide implementation of the HCBS rule?
- How is DHCS sharing best practices on the implementation of this new rule across the impacted state agencies?
- Has DHCS assessed whether or not some of these services will not comply with the HCBS rule before the March 2019 deadline? Will the state continue to fund these services?
- Is the state considering changes to licensing requirements for the facilities impacted by this new federal rule? How is DHCS working with the Department of Social Services on this?

## Department of Developmental Services

### BACKGROUND

The Department of Developmental Services (DDS) oversees the provision of services and supports to over 290,000 persons with developmental disabilities and their families, pursuant to the provisions of the Lanterman Developmental Disabilities Services Act, also known as the Lanterman Act, (Division 4.5 of the California Welfare and Institutions Code). The Lanterman Act establishes an entitlement to services and supports for Californians with developmental disabilities.

For the majority of eligible recipients, services and supports are coordinated through 21 private, non-profit corporations, known as regional centers (RCs). The remaining recipients are served in three state-operated institutions, known as developmental centers (DCs) and one state-leased and state-operated community-based facility.

**Eligibility.** To be eligible for services and supports through a regional center or in a state-operated facility, a person must have a disability that originates before their 18<sup>th</sup> birthday, be expected to continue indefinitely, and present a substantial disability. As defined in Section 4512 of the Welfare and Institutions Code, this includes an intellectual disability, cerebral palsy, epilepsy, and autism, as well as conditions found to be closely related to intellectual disability or that require treatment similar to that required for individuals with an intellectual disability. A person with a disability that is solely physical in nature is not eligible. Infants and toddlers (age 0 to 36 months), who are at risk of having a developmental disability or who have a developmental delay, may also qualify for services and supports (see the Early Start discussion later in this agenda). Eligibility is established through diagnosis and assessment performed by regional centers.

**Closure of Developmental Centers.** On October 1, 2015, DDS submitted to the Legislature a plan for the closure of the Sonoma Developmental Center (Sonoma). Pursuant to Welfare and Institutions Code Section 4474.11(a), implementation of this plan (or a modified version of this plan) is contingent on legislative approval during the 2016-17 budget process.

In addition, the May Revision of the proposed 2015-16 budget announced the planned closure of the remaining developmental centers. On November 30, 2015, DDS announced its intent to submit a plan to the Legislature by April 1, 2016, for the closure of the Fairview Developmental Center (Fairview) and the Porterville Developmental Center – General Treatment Area (Porterville GTA). In light of the planned and announced closures, the Governor's budget includes funds for both the Community Services and Developmental Centers Programs. These proposals are discussed in more detail below.

**Special Session.** On June 19, 2015, the Governor convened a special session of the Legislature to consider and act upon legislation related to the managed care organization (MCO) tax and to “increase oversight and the effective management of services provided to consumers with developmental disabilities through the regional center system,” among other provisions. This special session is still in progress. The budget proposes a new tax reform package to extend the MCO, see the Health Section for more details on this tax reform package. The Administration states that it expects any additional targeted spending proposals (such as rate increases related to DDS), above those included in the Governor’s budget and discussed below, to be funded from the extension of the MCO.

**Home and Community-Based Services (HCBS) Waiver.** Recent federal and state actions have articulated a growing preference for the delivery of services and supports that best promote integration and self-direction for persons with developmental disabilities. The implementation of these new initiatives will require a significant shift in how services and supports are provided in California. For example, under new federal home and community-based waiver and state plan regulations (that go into effect in 2019) waiver-funded services must meet certain criteria, including:

- The setting is integrated and supports full access to the greater community;
- The setting is selected by the individual from among options that include non-disability-specific settings and an option for a private unit in a residential setting;
- Ensure rights of privacy, dignity and respect, and freedom from coercion and restraint;
- Optimizes, but does not regulate, individual initiative, autonomy, and independence in making life choices; and,
- Facilitates individual choice regarding services and supports, and who provides them.

In California, DDS administers one waiver program and two state plan programs, serving approximately 130,000 persons.

## GOVERNOR’S PROPOSAL

The budget proposes for DDS expenditures of \$6.4 billion (\$3.8 billion General Fund), a net increase of \$394 million (6.6 percent) over the updated current year budget. See table below for more information.

Regional centers are anticipated to serve an average caseload of 291,507 individuals in the current year, and 303,266 individuals in the budget year, an increase of 11,759 or 4.03 percent. It is estimated that developmental centers will house 1,011 residents in 2015-16 and 847 residents in the budget year, a reduction of 164 or 16 percent.

## Department of Developmental Services Funding Summary

	2015-16	2016-17	Difference	Percent Change
Community Services	\$5,335,142	\$5,774,088	\$438,946	8.2%
Developmental Centers	574,160	526,037	-48,123	-8.4%
Headquarter Support	46,018	49,609	3,591	7.8%
<b>Total</b>	<b>\$5,955,320</b>	<b>\$6,349,734</b>	<b>\$394,414</b>	<b>6.6%</b>
<b>General Fund</b>				
Community Services	\$3,129,340	\$3,426,912	\$297,572	9.5%
Developmental Centers	348,778	307,481	-41,297	-11.8%
Headquarter Support	29,857	32,673	2,816	9.4%
<b>Total</b>	<b>\$3,507,975</b>	<b>\$3,767,066</b>	<b>\$259,091</b>	<b>7.4%</b>

**Developmental Centers.** Major proposals related to developmental centers include:

- **Closure Activities.** The budget includes \$18 million (\$12 million General Fund) to resolve open workers' compensation claims, inventory and archive clinical and historical records, execute an independent monitoring contract as stipulated by the federal government, and relocate residents and their personal belongs.
- **Staffing Adjustments.** The budget includes an \$8.8 million (\$4.9 million General Fund) decrease and a total reduction of 129.2 positions (63.1 Level of Care and 66.1 Non-Level of Care) based on an estimated population decline of 188 developmental center residents transitioning into the community. This reduction reflects adjustments to staffing for specialized support and closure activities.
- **Audit Findings.** The budget includes \$42.5 million General Fund in 2015-16 and \$3.8 million General Fund in 2016-17 in payments to the Department of Health Care Services related to audit findings of inappropriate claiming of federal funds.
- **Porterville Developmental Center – Secure Treatment Program.** The budget includes \$6.5 million General Fund for the construction phase (phase 2) of the project to upgrade the fire alarm system at this developmental center. Phase 1 of this project was approved in the 2015-16 budget.

**Community Services Program.** Major proposals related to regional centers include:

- **Caseload and Utilization.** The budget includes a \$235 million (\$149 million General Fund) increase in regional center operations and purchase of services (POS) in 2016-17. The major increases in POS services are within the day programs, support services, in-home respite, health care, and miscellaneous budget categories to reflect updated expenditure data and projected consumer population growth. The budget reflects a \$43.4 million (\$68.6 million) decrease in regional center expenditures for 2015-16, a 0.82 percent decrease, as a result of expenditure growth occurring at a slightly slower pace than previously estimated.

- **Development of Community Resources.** The budget includes \$146.6 million (\$127.2 million General Fund) to assist in the development of community resources for placement of current developmental center residents. This includes \$24.5 million for Sonoma Developmental Center, \$29.7 million for Fairview Developmental Center, and \$24.6 million for Porterville Developmental Center.
- **Research Unit.** The budget includes \$1.9 million (\$1.3 million General Fund) and 14 positions for audit functions and to create a new fiscal and research unit that would help develop accurate, reliable, and data-driven programmatic information and service trends.
- **Establish Four-bed Alternative Residential Model Homes Rates.** The budget includes \$46 million (\$26 million General Fund) to help transition and establish smaller four-bed homes for regional center clients living outside their family. Originally, this model was based on six-bed homes.
- **Case Managers.** The budget includes \$17 million (\$12 million General Fund) to fund additional regional center service coordinator positions to reduce caseload ratios and improve case management functions.
- **Compliance with HCBS Waiver.** The budget includes \$15 million (\$11 million General Fund) for targeted rate increases to providers to transition services, such as segregated day programs and sheltered workshops, to models that are more integrated and consistent with the HCBS Waiver.
- **Minimum Wage Increase.** The budget includes \$124.7 million (\$70.1 million General Fund), an increase of \$62.4 million (\$35 million General Fund), in POS to fund the requirements of AB 10 (Alejo), Chapter 351, Statutes of 2013, that increased the state minimum wage from \$9.00 to \$10.00 effective January 1, 2016.
- **Federal Labor Regulations.** The budget includes \$86.5 million (\$46.7 million General Fund), an increase of \$54.2 million (\$29.2 million General Fund), in POS to reflect full year implementation of the federal Fair Labor Standards Act to include home care workers in overtime compensation.
- **Transition of Behavioral Health Treatment (BHT) Services to Medi-Cal.** The budget includes a \$4.5 million (\$2.2 million General Fund) decrease in POS to reflect a reduction in expenditures for consumers who began receiving BHT services in September 2014 as a Medi-Cal benefit pursuant to SB 870 (Committee on Budget and Fiscal Review), Chapter 40, Statutes of 2014.
- **Rate Increases.** The Administration states that it expects any additional targeted spending proposals (such as rate increases) to be funded from the proposed extension of the managed care organization tax (as discussed in the Health Section of this report).

**Headquarters.** The budget includes the following proposals for headquarters:

- **Developmental Center Closure Efforts.** The budget includes \$2.1 million (\$1.8 million General Fund), eight new positions, and the redirection of five vacant positions for staffing and contract resources needed to support the continued efforts for the closure of the Sonoma, Fairview, and Porterville GTA. This includes overseeing the development and licensing of community facilities and consumer programs, supporting layoff activities, resolving workers' compensation claims, reconciling personnel and payroll records, and collaborating and communicating with stakeholders.
- **Fiscal and Program Research Unit.** The budget includes \$923,000 (\$630,000 million General Fund) and seven positions to establish a Fiscal and Program Research Unit. The new unit will compile, research, and analyze fiscal and programmatic data in response to legislative, federal government, and stakeholder inquiries regarding regional center and developmental center programs and the provision of services to persons with developmental disabilities.
- **HCBS Waiver Staff.** The budget proposes \$483,000 million (\$330,000 General Fund) and four positions to accommodate increased workload associated with complying with the HCBS waiver regulations. The new, comprehensive regulations create additional workload for planning, training, assessing, and reporting activities to demonstrate compliance by March 2019 in order for the state to maintain \$1.7 billion annually in federal financial participation reimbursements for POS expenditures.
- **Vendor Audit Section.** The budget includes \$952,000 (\$650,000 General Fund) to permanently establish and retain funding for seven auditor positions in the Vendor Audit Section. The positions, originally established as limited-term in 2014-15, would continue to provide audit coverage and oversight of the more than \$4.6 billion in vendor payments disbursed each fiscal year.

**Savings from Closing Developmental Centers.** As required by SB 82 (Committee on Budget and Fiscal Review), Chapter 23, Statutes of 2015, the budget includes information related to the estimated savings from closing down developmental centers and the costs to develop community resources and oversee closure activities. SB 82 stated the Legislature's intent that savings derived from developmental center downsizing and closure benefit persons with developmental disabilities living in the community. DDS does not identify any savings related to closures, but instead \$98 million (\$76.1 million General Fund) in expenditures necessary to develop community resources and implement closure-related activities. In 2015-16, DDS estimates \$8.8 million (\$4.9 million General Fund) in savings related to position reductions at developmental centers and \$137.7 million (\$108.2 million General Fund) in expenditures related to community development and closure activities. According to the department, as experienced in the closure of the Lanterman Developmental Center, savings are not realized until the developmental center is actually closed as there is a need to maintain a base level of developmental center staffing and infrastructure.

**ISSUES TO CONSIDER**

**Closer Monitoring of Community-Based Services Development for Developmental Center Movers is Needed.** The budget projects that 164 residents will transition from developmental centers to community based services in 2016-17, see table below for more details.

**Average In-Center Population at State Developmental Centers**

<b>Developmental Center</b>	<b>2015-16</b>	<b>2016-17</b>	<b>Change</b>
Canyon Springs	56	63	7
Fairview	238	178	-60
Porterville	373	378	5
Sonoma	344	228	-116
<b>Total</b>	<b>1011</b>	<b>847</b>	<b>-164</b>

In the fall of 2015, Senate staff requested an inventory of where these residents would transition to (i.e., the regional center catchment area) and the types of services needed to be developed to support this transition. Senate staff have not yet received this information. This inventory is critical to monitoring the development of these services.

Additionally, although the budget includes \$146 million for the development of community-services for developmental center movers, as noted in the table below, details on how these funds will be used, or how these funds will be tracked to ensure that progress has been made is not included. It will be important for the Legislature to engage DDS during the budget process on developing mechanisms to closely track these expenditures and the progress of developing these community services.

Community Placement Plan 2016-17 Funding Summary

	Sonoma	Fairview	Porterville	Regular CPP	Total
<b>Operations</b>	\$3,616,000	\$1,212,000	\$606,000	\$15,265,000	\$20,699,000
<b>Purchase of Services</b>					
Start-Up <sup>1</sup>	\$10,637,000	\$25,575,000	\$21,950,000	\$27,265,000	\$85,427,000
Assessment <sup>2</sup>				\$1,500,000	\$1,500,000
Number of Consumers				878	878
Placement <sup>3</sup>	\$10,247,000	\$2,886,000	\$2,063,000	\$22,824,000	\$38,020,000
Number of Consumers	54	24	17	145	240
Deflection <sup>4</sup>				\$1,000,000	\$1,000,000
Number of Consumers				70	70
<b>Total</b>	<b>\$24,500,000</b>	<b>\$29,673,000</b>	<b>\$24,619,000</b>	<b>\$67,854,000</b>	<b>\$146,646,000</b>

<sup>1</sup>Start-Up – These expenditures are related to development of new facilities, new programs, and program expansion.

<sup>2</sup>Assessment – These expenditures are for individualized and comprehensive identification of consumer supports and services needed for stabilized community living.

<sup>3</sup>Placement – These expenditures are for the phase-in of consumers to community settings based on consumer-specific information.

<sup>4</sup>Deflection – These expenditures are for related services needed to deflect the admission of individuals into developmental centers.

**No Budget Proposal on Supports for Developmental Center Employees.** The proposed plan for the closure of the Sonoma Developmental Center indicates that DDS is committed to the implementation of employee supports that promote workforce stability and provide opportunities for employees to determine their future. The plan also notes that the department will explore the possibility of retention bonuses, state service credit opportunities, and the ability to guarantee positions or specialized training for employees that stay through the end of the closure. The budget does not include any proposals related to supports for developmental center employees. The Legislature may wish to engage the department in discussions on any additional supports that may be needed to ensure a smooth transition and to encourage that these professionals who have developed an expertise continue to work with persons with developmental disabilities.

**Report on Allowable Developmental Closure Activities Not Yet Received.** Pursuant to supplemental reporting language of the 2015-16 budget, DDS was to provide to the Legislature a report on which developmental closure-related activities are allowable under existing laws and with closure-related activities shall only be permissible upon approval by the Legislature of a closure plan. The Legislature has not yet received this report.

**DDS’s Oversight of Regional Centers Needs Improvement.** The Lanterman Act establishes regional centers as private, non-profit agencies, each directed by the policies and decisions of a locally established board of directions. The intent is of this is that these boards and centers are in

the best position to understand the needs of the community. While it is important that the services provided by the regional centers reflect the needs of the community, the Lanterman Act establishes a statewide entitlement and it is the responsibility of DDS to ensure that this entitlement is provided in the most effective and efficient means possible.

As shown in the chart below, regional center expenditures have grown from \$4.1 billion in 2012-13 to \$5 billion in 2015-16, a 22 percent increase. Regional center caseload has grown from 270,601 in 2012-13 to 282,805 in 2015-16, a 12.1 percent increase. While some of this growth in expenditures can be attributable to the transition of individuals from developmental centers to the community and the aging of this population, DDS does not systematically present the reasons for this growth in any budget documentation. Nor does DDS publically provide regional center caseload or expenditure information.

**Regional Center Expenditures Changes from 2012-13 to 2015-16**

	<b>Amount Increased</b>	<b>Percent Increased</b>
Operations	\$74,363,531	14.49%
Purchase-of-Service	\$836,517,668	23.34%
<b>Total</b>	<b>\$910,823,414</b>	<b>22.22%</b>

Additionally, as shown in the chart below, there is great variance in the per capita spending by regional center. For example, the Central Valley Regional Center’s per capita expenditure in 2015-16 is \$13,929 and Golden Gate Regional Center’s per capita expenditure is \$29,977. It is likely that a significant portion of this per capita spending difference is related to the costs-of-living differences between the central valley and the Bay Area. The regional centers located in Los Angeles County have a per capita spending variance of about \$7,100 (with Westside Regional Center’s per capita expenditures at \$21,436 and Harbor Regional Center’s per capita expenditures at \$14,282), where cost-of-living differentials are less significant.

Table: Regional Center Expenditures and Caseload, 2012-13 - 2015-16										
	2012-13					2013-14				
	Operations	POS	Total	Caseload	Per Capita Cost	Operations	POS	Total	Caseload	Per Capita Cost
Alta California	\$33,000,235	\$255,473,701	\$288,473,936	17,477	\$16,506	\$34,646,782	\$265,221,280	\$299,868,062	18,107	\$16,561
Central Valley	30,105,401	158,857,892	188,963,293	15,063	12,545	31,974,835	169,368,143	201,342,978	15,588	12,917
East Bay	32,076,924	270,323,094	302,400,018	15,822	19,113	33,092,281	279,138,044	312,230,325	16,239	19,227
Eastern L.A.	19,555,068	141,135,682	160,690,750	9,205	17,457	20,484,458	151,887,797	172,372,255	9,518	18,110
Far Northern	14,046,299	98,506,415	112,552,714	6,496	17,326	14,580,770	103,303,740	117,884,510	6,577	17,924
Frank Lanterman	16,241,702	105,039,197	121,387,389	7,977	15,217	17,495,911	114,847,688	132,447,008	8,438	15,696
Golden Gate	18,730,404	178,476,348	197,206,752	7,927	24,878	19,419,268	189,568,802	208,988,070	8,219	25,427
Harbor	23,226,052	113,848,222	137,139,285	10,656	12,870	24,293,285	122,117,175	146,472,172	11,030	13,279
Inland	47,824,838	251,678,479	299,692,486	24,873	12,049	50,761,457	266,305,339	317,236,161	26,299	12,063
Kern	15,432,485	126,500,003	141,932,488	6,843	20,741	15,891,276	127,300,338	143,191,614	6,964	20,562
North Bay	16,473,169	127,888,292	144,361,461	7,518	19,202	17,270,066	136,775,668	154,045,734	7,661	20,108
North L.A.	34,211,467	254,669,177	289,003,365	18,102	15,965	36,282,816	273,679,248	310,075,257	18,873	16,430
Orange	31,317,007	237,109,785	268,584,824	17,151	15,660	31,620,058	253,752,997	285,510,751	17,263	16,539
Redwood Coast	7,920,459	69,856,048	77,776,507	2,933	26,518	8,191,224	72,583,103	80,774,327	3,010	26,835
San Andreas	27,378,133	270,742,446	298,120,579	13,471	22,131	28,425,067	283,938,411	312,363,478	13,983	22,339
San Diego	37,942,454	223,360,043	261,302,497	19,715	13,254	39,824,735	237,624,586	277,449,321	20,606	13,464
San Gab/Pomona	22,595,419	143,568,072	166,265,875	11,036	15,066	23,947,434	151,504,034	175,548,289	11,579	15,161
South Central	22,583,779	125,443,012	148,147,883	10,791	13,729	24,268,190	135,655,699	160,039,708	11,321	14,137
Tri-Counties	24,758,475	185,138,266	210,006,516	11,459	18,327	25,456,866	194,173,730	219,737,113	11,715	18,757
Valley Mountain	21,618,287	120,323,216	141,941,503	10,499	13,520	22,258,172	124,016,290	146,274,462	10,767	13,585
Westside	16,211,333	126,595,677	142,899,746	7,249	19,713	16,845,132	135,692,474	152,623,275	7,500	20,350
<b>Gross Total</b>	<b>\$513,249,390</b>	<b>\$3,584,533,067</b>	<b>\$4,098,849,867</b>	<b>252,263</b>	<b>\$16,248</b>	<b>\$537,030,083</b>	<b>\$3,788,454,586</b>	<b>\$4,326,474,870</b>	<b>261,257</b>	<b>\$16,560</b>
Includes about \$1 million for Family Resource Centers and Early Intervention Program.										
	2014-15					2015-16 <sup>2</sup>				
	Operations	POS	Total	Caseload	Per Capita Cost	Operations	POS	Total	Caseload	Per Capita Cost
Alta California	\$36,121,089	\$282,775,732	\$318,896,821	18,785	\$16,976	\$37,513,955	\$309,019,642	\$346,533,597	19,499	\$17,772
Central Valley	33,093,097	183,862,378	216,955,475	15,931	13,618	34,261,883	197,929,060	232,190,943	16,670	13,929
East Bay	35,012,715	296,803,112	331,815,827	16,709	19,859	36,946,782	331,133,897	368,080,679	17,607	20,905
Eastern L.A.	21,312,601	163,211,768	184,524,369	9,903	18,633	22,317,784	170,535,900	192,853,684	10,437	18,478
Far Northern	15,037,279	109,644,691	124,681,970	6,727	18,535	15,666,371	120,002,146	135,668,517	7,023	19,318
Frank Lanterman	18,313,743	126,620,284	145,039,465	8,714	16,644	18,922,589	133,514,995	152,543,022	9,033	16,887
Golden Gate	20,101,119	204,670,333	224,771,452	8,348	26,925	20,613,769	233,589,272	254,203,041	8,481	29,973
Harbor	25,234,681	135,192,606	160,490,209	11,213	14,313	26,066,551	141,241,070	167,370,543	11,719	14,282
Inland	54,180,496	304,018,953	358,372,136	27,634	12,969	55,886,277	334,529,061	390,588,025	29,222	13,366
Kern	16,862,788	131,610,042	148,472,830	7,256	20,462	16,708,737	142,726,226	159,434,963	7,485	21,301
North Bay	17,927,901	147,030,667	164,958,568	7,787	21,184	18,593,044	166,187,704	184,780,748	7,901	23,387
North L.A.	38,166,927	296,690,129	334,972,469	19,734	16,974	39,968,370	317,218,871	357,302,654	20,921	17,079
Orange	34,496,887	273,796,321	308,433,605	17,996	17,139	36,487,434	285,057,674	321,685,505	18,809	17,103
Redwood Coast	8,647,477	76,277,275	84,924,752	3,121	27,211	9,185,800	79,465,407	88,651,207	3,301	26,856
San Andreas	29,575,330	299,483,212	329,058,542	14,485	22,717	30,742,894	321,411,168	352,154,062	15,051	23,397
San Diego	42,306,351	258,074,407	300,380,758	21,475	13,987	44,231,719	280,583,893	324,815,612	22,870	14,203
San Gab/Pomona	25,341,195	165,340,880	190,780,795	11,871	16,071	26,019,548	176,204,070	202,322,338	12,170	16,625
South Central	26,375,132	152,616,062	179,109,285	12,066	14,844	26,392,679	159,954,549	186,465,319	12,198	15,287
Tri-Counties	26,941,434	207,881,080	234,931,121	12,115	19,392	27,955,802	220,974,902	249,039,311	12,639	19,704
Valley Mountain	23,296,004	133,923,754	157,219,758	11,060	14,215	24,421,467	145,945,733	170,367,200	11,716	14,541
Westside	17,894,510	150,016,738	167,998,598	7,671	21,900	18,709,466	153,825,495	172,622,311	8,053	21,436
<b>Gross Total</b>	<b>\$566,238,756</b>	<b>\$4,099,540,424</b>	<b>\$4,666,788,805</b>	<b>270,601</b>	<b>\$17,246</b>	<b>\$587,612,921</b>	<b>\$4,421,050,735</b>	<b>\$5,009,673,281</b>	<b>282,805</b>	<b>\$17,714</b>
<sup>1</sup> Includes about \$1 million for Family Resource Centers and Early Intervention Program.										
<sup>2</sup> Includes allocations as of August 21, 2015. A total of \$5,273,588,000 is expected to be allocated in 2015-16 (\$620,137,000 for operations and \$4,468,704,000).										

Additionally, the current system does not provide a mechanism to easily and systematically evaluate the outcomes achieved with these expenditures. While DDS maintains performance contracts with each regional center, the goals and metrics included in these contracts, such as “more adults live in home settings” and “passes DDS audit,” do not evaluate the quality of services provided or the outcomes of these services (such as improved quality of life, prevention of secondary conditions, and slowing decline of activities of daily living).

DDS has maintained a consumer satisfaction survey (the National Core Indicators survey), but it is not clear how the results of these surveys were used to hold regional centers accountable for performance, as the last posted survey for children is for 2012-13 and 2011-12 for adults.

**Mechanisms to Improve State’s Oversight of Regional Center Performance.** The Legislature should consider the following as mechanisms to improve oversight of regional center performance:

- **Implement a Quality and Performance Dashboard.** The Legislature may want to consider establishing a quality dashboard for regional centers. The Department of Health Care Services maintains a “Medi-Cal Managed Care Performance Dashboard” that it publishes quarterly. This dashboard contains comprehensive data on a variety of measures including enrollment, health care utilization, appeals and grievances, network adequacy and quality of care by health plan. Information contained in the dashboard assists DHCS and its stakeholders in observing and understanding both individual and statewide managed care plan performance.
- **Report Consumer Complaints.** DDS maintains processes for consumer rights complaints and language access complaints, for example, but does not publically report the number and nature of these complaints. The Legislature may want to consider requiring DDS to publically report on this information by regional center on an annual basis.
- **Require More Detail in Publically-Available Budget Documents.** The current budget documents do not include any details on the caseload or the level of funding per regional center. This type of information should be easily available to the Legislature and public. The Legislature may consider directing the department to include certain basic information regarding regional center expenditures and caseloads in its budget documentation.
- **Direct Proposed Funding for Case Managers.** As described above, the budget includes \$17 million (\$12 million General Fund) to fund additional regional center service coordinator positions to reduce caseload ratios and improve case management functions. Regional center case management services are eligible for federal funding participation for consumers enrolled under the HCBS waiver. The Association of Regional Center Agencies, in a 2013 report, found that a number of regional centers are not meeting caseload ratio requirements under the HCBS waiver, putting California at risk for a loss in federal funding. DDS should direct regional centers to use this increased funding to meet federal caseload ratio requirements under the HCBS waiver; thereby not jeopardizing the loss of federal funds related to the HCBS waiver.

**Proposal for Fiscal and Program Research Unit Has Merit, Legislature Should Consider Specifying Metrics and Analyses.** DDS's proposal to create a fiscal and program research unit is worthwhile. Many other health and human services departments have similar units and provide valuable research to guide policy decisions. According to the proposal, the primary function of the unit would be to compile, research, and analyze data; prepare reports; and develop analytic products to inform policy and assist DDS in achieving its mission. The Legislature may want to specify metrics and analyses that it wants regularly reported. For examples:

- **Analysis of Disparities in Regional Center Services.** DDS and regional centers are required to annually collaborate to compile data in a uniform manner relating to POS authorization, utilization, and expenditure by regional center and by specified demographics including age, race, ethnicity, primary language spoken by consumer, disability, and other data. Additionally, as required by SB 82, annual performance objectives are included in DDS's contract with each regional center to measure progress in reducing disparities and improving equity in POS expenditures.

A review of 2014-15 data, indicates that in most regional centers, the per capita expenditures for "white" consumers age 22 years and older is higher than expenditures for Asian, African-American, or Hispanic. There has not been an analysis of the causes of these differences or even an investigation into the differences. The Legislature may want to direct this new research unit to analyze this data and develop methodologies to link these data to future policy changes.

- **Transparency in Regional Center Per Capital Expenditure Variances.** As shown in the table above, there are significant variances in the per capita expenditures by regional center expenditures. The Legislature may want to direct this new research unit to evaluate these differences and to publically provide analysis as to the reason for these variances.
- **Analysis Linking Caseload Demographics to Trends in Regional Center Expenditures.** DDS collects various types of data on demographics, diagnosis, and service utilization; however, linking and analyzing this information for purposes of understanding budgetary trends and changes does not routinely occur. The Legislature may want to require certain analytics related to explaining budgetary changes.

**Budget Does Not Include Funding for Rate Study.** The Developmental Services (DS) Task Force, convened in July 2014 by the Secretary for Health and Human Services, has had substantial discussion regarding California's complex rate methodology for community services. The Administration indicates its plan to pursue a rate study to evaluate a new rate system. The Administration notes that this rate study would be guided by the points of consensus made by the Rate Workgroup as part of the DS Task Force on June 5, 2015. It is expected that such a study would take at least two years and any implementation would likely be years later. While DDS indicates that it hopes the rate study request for procurement would be available in the next few months, the budget does not include a request for funding for this procurement.

It is urgent that such an evaluation of rate methodologies occur as soon as possible. The state's system of reimbursement is unclear, unstandardized, and does not necessarily incentivize quality outcomes or performance. As part of this rate study, the Administration should request an

evaluation of alternative payment methodologies that consider efficiency, effectiveness, quality of care, and consumer engagement.

Pending the findings of a rate study, the Legislature and the Administration should continue to monitor provider stability and eligibility for federal funding and take actions necessary to ensure access to services and supports is not diminished while the rate study is being completed.

**Regional Center Budget Is Not Adjusted Per Governor’s Proposal To Increase SSI/SSP.**

The regional centers supplement the 2011 reduction in the SSP portion of the SSI/SSP grant to assure that consumers are able to remain in their homes. The budget does not include an adjustment to regional center expenditures to reflect the Governor’s proposed cost-of-living adjustment increase the SSP (state) portion of the SSI/SSP grant by \$40.7 million General Fund, effective January 1, 2017. It is unclear, at this point, the needed level of adjustment.

# In-Home Supportive Services

## BACKGROUND

The In-Home Supportive Services (IHSS) program provides personal care services to approximately 490,000 qualified low-income individuals who are blind, aged (over 65), or who have disabilities. Services include feeding, bathing, bowel and bladder care, meal preparation and clean-up, laundry, and paramedical care. These services help program recipients avoid or delay more expensive and less desirable institutional care settings. A proposed budget of \$9.2 billion (\$3 billion General Fund) for services and administration includes funding for compliance with federal overtime regulations.

**Service Delivery.** County social workers determine IHSS eligibility and perform case management after conducting a standardized in-home assessment of an individual's ability to perform activities of daily living. In general, most social workers reassess annually recipients' need for services. Based on authorized hours and services, IHSS recipients are responsible for hiring, firing, and directing their IHSS provider(s). If an IHSS recipient disagrees with the hours authorized by a social worker, the recipient can request a reassessment, or appeal their hour allotment by submitting a request for a state hearing to the Department of Social Services (DSS). According to DSS, around 73 percent of providers are relatives, or "kith and kin."

In the current year, IHSS providers' combined hourly wages and health benefits vary by county, and range from approximately \$9.00 to \$18.00 per hour. Prior to July 1, 2012, county public authorities or nonprofit consortia were designated as "employers of record" for collective bargaining purposes on a statewide basis, while the state administered payroll and benefits. Pursuant to 2012-13 trailer bill language, however, collective bargaining responsibilities in seven counties – Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, and Santa Clara – participating in Coordinate Care Initiative (CCI) shifted to an IHSS Authority administered by the state. The CCI is discussed further below.

**Program Funding.** The average annual cost of services per IHSS client is estimated to be around \$15,500 for 2015-16. The program is funded with federal, state, and county resources. Federal funding is provided by Title XIX of the Social Security Act. Prior to July 1, 2012, the state and counties split the non-federal share of IHSS funding at 65 and 35 percent, respectively. A 2012-13 budget trailer bill changed this structure as of July 1, 2012, with county IHSS costs based on a maintenance-of-effort (MOE) requirement. The change was related to enactment of the CCI.

**Coordinated Care Initiative.** CCI requires Cal Medi-Connect to coordinate medical, behavioral health, long-term institutional, and home and community-based services, and to administer IHSS according to current program standards and requirements. The intent of CCI is to improve integration of medical and long-term care services through the use of managed health care plans and to realize accompanying fiscal savings. As IHSS becomes a Medi-Cal managed care benefit in the seven counties, each county is responsible for paying a MOE amount, not a percentage of program costs.

**Other Policy Changes.** Several recent policies have also impacted the IHSS program, including:

- **Reduction of IHSS recipient hours.** A legal settlement related to *Oster v. Lightbourne* and *Dominguez v. Schwarzenegger*, resulted in an eight percent reduction to authorized IHSS hours, effective July 1, 2013. Beginning in July 1, 2014, the reduction in authorized service hours was changed to seven percent. The 2015 Budget Act approved \$225.9 million in one-time General Fund resources, and related budget bill language, to offset the seven-percent across-the-board reduction in service hours.
- **Minimum wage increases.** Assembly Bill 10 (Alejo), Chapter 351, Statutes of 2013, increased the minimum wage from \$8 per hour to \$9 per hour in July 2014, with gradual increases until the minimum wage meets \$10 per hour by January 2016. 29 counties will be impacted by the minimum wage increase in 2016-17. All non-federal IHSS provider wage costs will be funded by the General Fund, around \$71 million for 2015-16 and \$150 million for 2016-17.
- **Fair Labor Standards Act (FLSA)—Final Rule.** FLSA is the primary federal statute dealing with minimum wage, overtime pay, child labor, and related issues. Under current law, some provisions of the FLSA do not apply to certain employees, including the “Companionship Services Exemption” for domestic service employees who: 1) provide babysitting services on a casual basis, or 2) provide “companionship services” to individuals who are unable to care for themselves. Federal regulations define “companionship services” as services that provide fellowship, care, and protection for a person who, because of advanced age or physical or mental disability, cannot care for his or her own needs. These services may include household work, such as meal preparation, bed-making, clothes washing, and other similar services that can be provided through IHSS. General housework may also be included, subject to some limitations. Current regulations exempt employees of third-party agencies and live-in domestic service employees who provide companionship services from overtime regulations in FLSA.

In September 2013, the U.S. Department of Labor (US DOL) issued a final rule, effective January 1, 2015, which redefined “companionship services;” limited exemptions for “companionship services” and “live-in domestic service employees” to the individual, family, or household using the services (not a third party employer). The rule also required compensation for activities, such as travel time between multiple recipients, wait time associated with medical accompaniment, and time spent in mandatory provider training. Under the final rule, employers must pay at least the federal minimum wage (\$7.25) and overtime pay at one and a half times the regular pay if a provider works more than 40 hours per work week. However, due to various court actions, the final rule is being implemented in California effective February 1, 2016.

SB 855 (Committee on Budget and Fiscal Review) Chapters 29, Statutes of 2014, established a limit of 66 hours per week for IHSS providers based on the statutory maximum of 283 hours a month for IHSS recipients, and limited travel time for providers to seven hours a week. DSS or counties may terminate a provider in the event of persistent violations of

overtime or travel limitations. There is a three month hold-harmless period for IHSS providers as overtime changes take effect.

## GOVERNOR'S 2016-17 BUDGET PROPOSALS:

**Fair Labor Standards Act Implementation.** The budget assumes FLSA regulations, as set forth under SB 855 (Committee on Budget and Fiscal Review) Chapters 29, Statutes of 2014, will begin on February 1, 2016, and provides \$580 million (\$270 million General Fund) in 2015-16, and \$850 million (\$393 million General Fund) in 2016-17, for the implementation of the federal requirements. The \$850 million is allocated as follows:

- \$475 million for FLSA regulations
- \$366 million for FLSA compliance (medical accompaniment wait time, travel time, and mandatory provider training)
- \$5 million for FLSA administration
- \$4 million for the Case Management, Information and Payrolling System (CMIPS)

**Restoration of the seven percent reduction in service hours.** The 2016-17 Governor's budget proposes to use a portion of the revenues from a restructuring of the existing Managed Care Organization (MCO) tax to restore the seven percent across-the-board reduction beginning July 1, 2016. The cost for the seven percent restoration is estimated at \$236 million General Fund in 2016-17.

## ISSUES TO CONSIDER

**Overtime compensation.** The budget implements the US DOL regulations that require overtime pay for domestic workers beginning February 1, 2016. In considering implementation of this proposal, the Legislature may wish to consider the following:

- **Creating exemptions.** SB 855 specifies that IHSS providers are not permitted to work more than 66 authorized hours in a workweek. This restriction may have a negative impact on providers with multiple live-in recipients, such a mother caring for two children with disabilities. It could also be problematic for recipients of the Waiver for Personal Care Services (WPCS), which is a program through Medi-Cal where IHSS recipients are authorized additional hours once they have used all of the authorized state plan IHSS hours. There are an estimated 760 cases in 2015-16 of providers with multiple IHSS recipients in their home, and 1,588 recipients receiving extra hours under the WPCS waiver.

The Governor's budget does not assume exceptions to the SB 855 limits; however, DSS recently released draft notices to counties that provide general information regarding: 1) an exemption to caps on overtime that affect eligible family live-in IHSS workers and, 2) a temporary case-by-case exemption for "extraordinary circumstances" as defined for IHSS workers. The Legislature may want to consider how to ensure that these populations are not

negatively impacted by the caps, and decide whether the Governor's administrative approach is sufficient, or if a statutory change is needed.

- **Continued Monitoring of Implementation.** As implementation of FLSA goes into effect in California, the Legislature should continue to monitor how providers and recipients are faring under the new regulations and ensure that any unanticipated problems with implementation are addressed. Around the time of the May Revision, the three month "non-enforcement" period of workweek caps (during which DSS will not yet terminate providers for violation of hour limits) will expire, presenting a suitable time to take a closer look at how implementation is proceeding. Specifically, the Legislature should monitor:
  - **Recipients.** Do recipients understand the workweek caps and how it may affect their providers and the care they receive? Are recipients receiving help to find additional providers, if needed? Are recipients still receiving all of the services they need?
  - **Providers.** Do providers understand the workweek caps and the consequences of exceeding the caps? Have providers received training on how to fill out their timesheets? Are providers receiving their payments on time?
  - **CMIPS.** How is CMIPS handling the implementation of the overtime regulations? Is the system functioning smoothly, or has it experienced any issues related to overtime regulations?

**Alternatives for funding the seven percent restoration.** The restoration of the seven percent reduction in service hours for IHSS recipients was funded in 2015-16 as a one-time General Fund allocation. The Governor's budget proposes to use funds from the restructured MCO tax to restore the seven percent restoration; however, it is still uncertain whether the MCO tax will successfully pass the Legislature. The Legislature may wish to ask the Legislative Analyst's Office to identify what other alternatives to fund the seven percent restoration if the MCO tax does not pass.

# Supplemental Security Income/State Supplemental Payment

## BACKGROUND

The Supplemental Security Income/State Supplemental Payment (SSI/SSP) programs provide cash assistance to around 1.3 million Californians, who are aged 65 or older (28 percent), are blind (one percent), or have disabilities (71 percent), and in each case meet federal income and resource limits. A qualified SSI recipient is automatically qualified for SSP. SSI grants are 100 percent federally funded. The state pays SSP, which augments the federal benefit. The federal Social Security Administration (SSA) administers the SSI/SSP program for California. Costs for SSI/SSP include the California Veterans Case Benefit Program and the Cash Assistance Program for Immigrants, discussed below. The SSI/SSP caseload has experienced slow and steady growth over the last decade at an average of approximately 0.9 percent annually. The caseload growth for 2016-17 continues this trend, growing from 1,307,789 in 2015-16 to 1,311,082 individuals, or an increase of 0.8 percent.

**Cost-of-Living Adjustment.** Under current law, both the federal and state grant payments for SSI/SSP recipients are adjusted for inflation each January through Cost-of-Living Adjustments (COLAs). Federal law provides an annual SSI COLA based on the Consumer Price Index (CPI), and state law provides an annual SSP COLA based on the California Necessities Index (CNI). The state COLA for the SSP grant was suspended periodically throughout the 1990s and into the 2000s, with the last increase in 2005. The SSP COLA was permanently suspended in 2011 through statute.

**Maintenance-of-Effort and Other Benefit Programs.** The federal government has established a maintenance-of-effort (MOE) for the amount of SSP paid by California. The current SSP grant MOE for individuals and couples is set at the state's March 1983 payment level. Violating this MOE would risk all of the state's Medicaid funding. There are 25 eligibility categories, each with a unique maximum grant level. In addition, California's SSI/SSP beneficiaries are ineligible for CalFresh benefits, which provide monthly benefits to assist low-income households with purchasing food. Through a federal arrangement, the state provides \$10 within the SSP grant for recipients to purchase food in lieu of CalFresh benefits. The \$10 has not been increased since 1975 when the policy was established; however, the amount is indistinguishable from the SSI/SSP grant or any subsequent increases.

**Cash Assistance Program for Immigrants.** In 1998, the Cash Assistance Program for Immigrants (CAPI) was established as a state-only program to serve some legal non-citizens who were aged, blind, or had disabilities. After 1996 federal law changes, most entering immigrants were ineligible for SSI, although those with refugee status are allowed seven years of SSI. CAPI benefits are equivalent to SSI/SSP program benefits, less \$10 per individual and \$20 per couple. The CAPI recipients in the base program include 1) immigrants who entered the United States prior to August 22, 1996, and are not eligible for SSI/SSP benefits solely due to their

immigration status; and 2) those who entered the U.S. on or after August 22, 1996, but meet special sponsor restrictions (have a sponsor who is disabled, deceased, or abusive). The extended CAPI caseload, which is separate from the base CAPI caseload, includes immigrants who entered the U.S. on or after August 22, 1996, who do not have a sponsor or have a sponsor who does not meet the sponsor restrictions of the base program. In 2016-17, the estimated monthly average caseload is 15,099 cases for both CAPI and extended CAPI.

**California Veterans Cash Benefit Program Program.** The California Veterans Cash Benefit Program (CVCB) program is linked to the federal Special Veterans Benefit (SVB) Program, which was signed into law in 1999 and provides benefits for certain World War II veterans. The SVB application also serves as the CVCB application, and payments for both programs are combined and issued by the SSA. CVCB program benefits are specifically for certain Filipino veterans of World War II who were eligible for CA SSP in 1999, who are eligible for the SVB program, and who have returned to live in the Republic of the Philippines. The department estimates that the caseload is around 375 cases. Grant levels are identical to the SSP portion for individuals.

**Grant Levels.** The chart below displays the maximum monthly SSI/SSP grant for individuals and couples in 2007–08, as compared to grant levels for 2015–16. Reflecting SSP grant reductions and the suspension of the state COLA, the combined SSI/SSP maximum monthly grant for individuals and couples has declined as a percentage of federal poverty level (FPL) over the nine–year period.

**SSI/SSP Maximum Monthly Grants  
Pre- and Post-Recession**

	2007-08	2015-16
<b>Maximum Grant—Individuals</b>		
SSI	\$637	\$733
SSP	233	156
<b>Totals</b>	<b>\$870</b>	<b>\$889</b>
Percent of FPL	102.3%	90.6%
<b>Maximum Grant—Couples</b>		
SSI	\$956	\$1,100
SSP	568	396
<b>Totals</b>	<b>\$1,524</b>	<b>\$1,496</b>
Percent of FPL <sup>1</sup>	133.6%	112.7%

<sup>1</sup> FPL = federal poverty level

If the SSP COLA had been applied annually since 2005, when the last COLA was given to the SSP grant, the maximum grant for individuals would be \$1,052 and the maximum grant for couples would be \$1,868 in 2015-16.

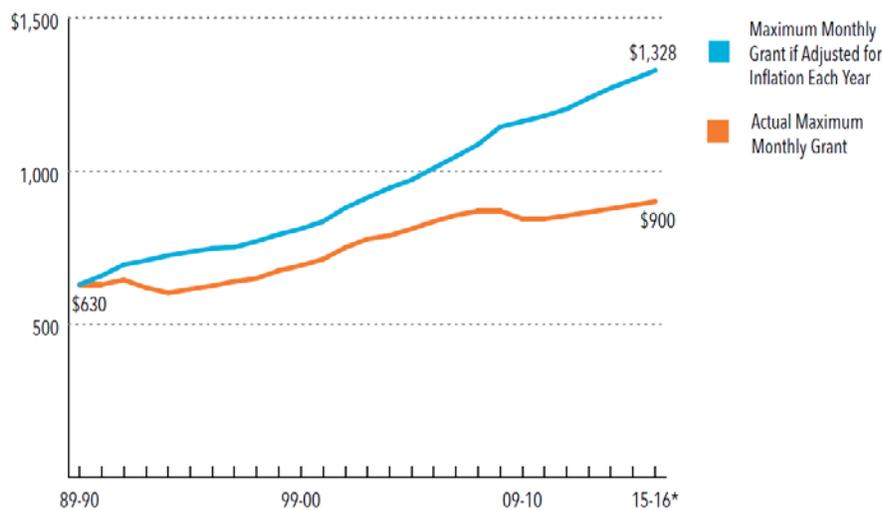
According to the Legislative Analyst’s Office (LAO), after adjusting for inflation, the maximum combined SSI/SSP grant for 2015-16 has declined significantly in purchasing power since 2007-08:

- Represents roughly \$76 (8.7 percent) less purchasing power for individuals.
- Represents roughly \$190 (12.4 percent) less purchasing power for couples.

According to the California Budget and Policy Center, fair market rent for a studio apartment exceeds one-half of the SSI/SSP grant for an individual in all 58 counties and is actually higher than the entire grant for 15 counties.<sup>2</sup> The chart below compares an individual’s SSI maximum grant amount as a percentage of the federal poverty level and demonstrates its loss of purchasing power since 1989.

### SSI/SSP Grants Have Lost Nearly One-Third of Their Purchasing Power Since 1989-90

Maximum Monthly SSI/SSP Grant for Individuals Who Are Elderly or Have Disabilities



Source: California Budget and Policy Center. “California Budget Perspective 2015-16.” March 2015.

**SSI/SSP Grant and Poverty.** In 2013, 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

<sup>2</sup> <http://calbudgetcenter.org/wp-content/uploads/Fact-Sheet-3.11.15-Due-to-State-Cuts-SSI-SSP-Grants-Lose-Ground-to-Housing-Costs.pdf>

resources, such as commuting costs, out-of-pocket medical expenses, and childcare costs; and geographic differences in housing costs.<sup>3</sup> According to the 2013 U.S. Census Bureau figure, California’s current official poverty measure is 16 percent; under the SPM, its poverty rate over 2011-2013 averaged 23.4 percent—the highest of any state in the nation.

Poverty rates vary significantly across California’s counties. Based on the California Poverty Measure (CPM), which accounts for the cost-of-living and a range of family resources, including social safety net benefits, the table below shows the poverty rates across counties as calculated by the Public Policy Institute of California. According to this measure, in 2013, Placer County had the lowest poverty rate (13 percent), and Los Angeles had the highest (26 percent)<sup>4</sup>.

**Poverty Rates in California By County**

County	Poverty rate	County	Poverty rate	County	Poverty rate
Alameda	17.6%	Madera	21.1%	San Mateo	17.0%
Alpine, Amador, Calaveras, Inyo, Mariposa, Mono, Tuolumne	16.5	Marin	16.6	Santa Barbara	24.1
Butte	21.6	Merced	21.4	Santa Clara	18.0
Colusa, Glenn, Tehama, Trinity	15.9	Monterey, San Benito	24.0	Santa Cruz	21.8
Contra Costa	16.9	Napa	18.1	Shasta	18.0
Del Norte, Lassen, Modoc, Siskiyou, Plumas, Nevada, Sierra	18.3	Orange	21.8	Solano	16.9
El Dorado	14.0	Placer	13.3	Sonoma	17.2
Fresno	21.2	Riverside	20.1	Stanislaus	21.5
Humboldt	19.7	Sacramento	18.2	Sutter, Yuba	16.6
Imperial	17.3	San Bernardino	19.4	Tulare	22.1
Kern	18.2	San Diego	21.5	Ventura	19.6
Kings	17.7	San Francisco	22.6	Yolo	21.4
Lake, Mendocino	22.8	San Joaquin	18.3		
Los Angeles	25.7	San Luis Obispo	19.1		

Source: Public Policy Institute of California. “Just the Facts: Poverty in California.” December 2015. [http://www.ppic.org/main/publication\\_show.asp?i=261](http://www.ppic.org/main/publication_show.asp?i=261)

The lack of affordable housing in California is a major contributor to poverty in the state, and causes significant hardship for SSI/SSP recipients. According to a 2015 study by the California Housing Partnership Corporation, California has a shortfall of 1.5 million affordable homes and 13 of the 14 least affordable metropolitan areas in the country. The availability of affordable housing also varies greatly by geographic location across the state.

<sup>3</sup> Kathleen Short. "The Supplemental Poverty Measure: 2013." *U.S. Census Bureau, Economics and Statistics Administration*. October 2014.

<<http://www.census.gov/content/dam/Census/library/publications/2014/demo/p60-251.pdf>>

<sup>4</sup> Public Policy Institute of California. “Just the Facts: Poverty in California.” December 2015.

[http://www.ppic.org/main/publication\\_show.asp?i=261](http://www.ppic.org/main/publication_show.asp?i=261)

**GOVERNOR’S PROPOSAL**

**Budget Proposal.** The budget proposes \$10.3 billion total funds (\$2.9 billion General Fund) for SSI/SSP. The state pays administration costs for SSP, around \$189 million for the budget year. From 2015-16 to budget year, the budget is projected to increase by \$23.5 million General Fund due to a projected average monthly caseload growth and increase in the average grant. Additionally, the budget proposes to provide a COLA to the SSP portion of the grant. A COLA using the California Necessities Index (CNI) of 2.96 will be applied to the SSP portion of the grant beginning January 1, 2017. Half-year costs are \$40.7 million General Fund.

**Maximum Grants After the Proposed SSI/SSP Increase.** As highlighted in the table below, the proposed state COLA would increase the SSP portion of the maximum grant by \$4.63 per month for individuals and \$11.73 per month for couples. Together with the estimated federal COLA, this proposal would raise individual grants by \$17.09 per month, and couples’ grants by \$30.43 per month.

The combined state and federal COLAs would raise the individual maximum SSI/SSP grant to 92 percent of the 2015 federal poverty level, and the couples’ maximum SSI/SSP grant to 115 percent of the 2015 federal poverty level. The federal poverty level for 2016 and 2017 has not yet been released, but it typically increases annually.

**SSP Grants and the Federal Poverty Level**

<b>SSI/SSP Maximum Monthly Grants</b>			
	<b>2016 Current Law Grant Levels</b>	<b>2017 Governor's Proposal</b>	<b>Difference</b>
<b>Individuals a&gt;</b>			
SSI	\$733.00	\$745.46	\$12.46
SSP	\$156.40	\$161.03	\$4.63
<b>Totals</b>	<b>\$889.40</b>	<b>\$906.49</b>	<b>\$17.09</b>
<i>Federal Poverty Level</i>	\$980.83	\$980.83	
<b>Percent of Poverty b&gt;</b>	<b>91%</b>	<b>92%</b>	
<b>Couples c&gt;</b>			
SSI	\$1,100.00	\$1,118.70	\$18.70
SSP	\$396.20	\$407.93	\$11.73
<b>Totals</b>	<b>\$1,496.20</b>	<b>\$1,526.63</b>	<b>\$30.43</b>
<i>Federal Poverty Level</i>	\$1,327.50	\$1,327.50	
<b>Percent of Poverty b&gt;</b>	<b>113%</b>	<b>115%</b>	
a> Individuals category refers to aged or disabled individuals living independently in his/her own household. b> Compares grant level to federal poverty guideline from the U.S. Department of Health and Human Services in 2015. c> Couples category refers to aged or disabled couples living in their own household.			

Source: Legislative Analyst’s Office. January 2016.

**ISSUES TO CONSIDER**

**Impact of SSP COLA.** The Governor's proposal to apply a COLA to the SSP grant represents the first increase to this grant since 2005. The Legislature should carefully consider the implications of the proposed grant increase, particularly how the amount will impact recipients and how it fits into the overall larger picture of reducing poverty.

- **What is the right amount?** The Legislature should consider whether a \$4.63 increase to current individual grant levels is an appropriate increase, and how it will benefit recipients, and explore different options of how to apply the COLA to the SSI/SSP grant.
- **Various COLA options.** Other methodologies can be used to provide an adjustment to the SSI/SSP COLA. The Governor's proposal applies the CNI to only the SSP portion. However, in prior SSI/SSP grant increases, the CNI was applied to the entirety of the grant. Additionally, the Governor's proposal is a one-time increase. Prior to 2011, the Legislature had the ability to provide annual COLA adjustments to SSP portion of the grant. The Legislature may wish to reevaluate the impact of statutory language that suspends the state portion of the COLA increase on recipients and what the costs of reinstating an annual COLA would be in the longer term.
- **Senate Homelessness Plan.** The Senate Pro Tem and several other Senators have proposed a "No Place Like Home" initiative that includes state-level policy changes and investments intended to assist local governments in tackling the homelessness problem. The plan includes an augmentation to SSI/SSP grants, although the details are not yet specified.

**Social Safety Net Programs.** Safety net programs serve a variety of individuals who may be eligible for multiple services. The SSI/SSP program is designed to help people who are aged, blind, or disabled, and who in each case have little or no income to meet their basic needs. The rising costs of housing, food, utilities, and other necessities place unnecessary stress on California's households, particularly for vulnerable populations. Given this, it is important to consider how various economic factors play in to the needs of SSI/SSP recipients, and how the SSI/SSP program works with other safety net programs to lift Californians out of poverty. The Legislature may wish to consider other social programs along with SSI/SSP as a whole, and examine how they interact with each other and can be designed better to assist Californians who are currently experiencing, or at risk of, poverty.

# SUBCOMMITTEE NO. 4

## STATE ADMINISTRATION and GENERAL GOVERNMENT

### **State Administration and General Government**

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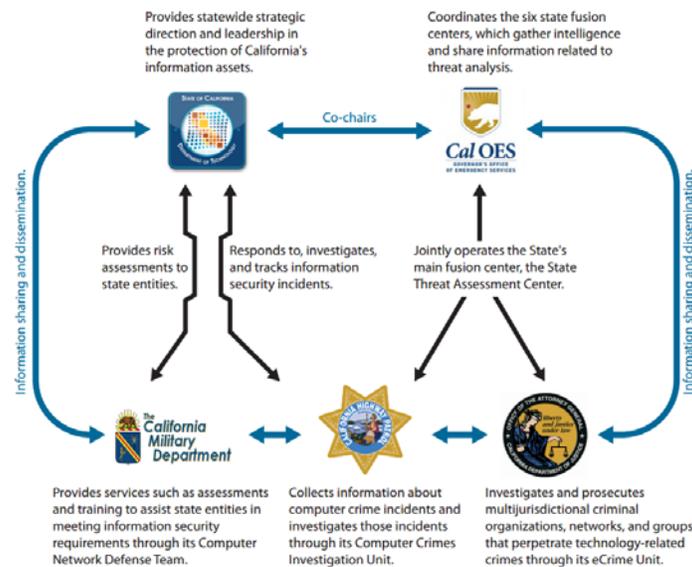
# Cybersecurity

## BACKGROUND

Cybersecurity protects computers, networks, programs, and data from unintended or unauthorized access or changes.<sup>1</sup> In 2012, according to the Attorney General’s *2014 Data Breach Report*, 17 percent of the nation’s recorded data breaches occurred in California. In 2014 and 2015, Target, Home Depot, JP Morgan Chase, Wells Fargo, Sony, the University of California, and Los Angeles Health were all subject to significant cyberattacks. More recently, insurance company Anthem Inc. suffered a breach that exposed nearly 80 million customer records, including Social Security numbers. Because California administers a wide variety of programs, employs over 220,000 people, and its various state departments and agencies house sensitive client information (such as medical records, Social Security numbers, tax filings, location of oil resources, and defense or law enforcement information), it is critical to understand how state entities are safeguarding their data systems. In 2013, the Governor established the California Cybersecurity Task Force, comprised of stakeholders, subject matter experts, and cybersecurity professionals, to enhance the state’s digital information. The figure below, created by the State Auditor’s Office, shows the interaction of several state entities on the Task Force.

### State Entities in the California Cybersecurity Task Force

**Figure 1**  
Key State Entities Related to Information Security That Are Members of the California Cybersecurity Task Force



Sources: California State Auditor's review of the joint assembly informational hearing on state-level cybersecurity and documents related to the California Cybersecurity Task Force and its members.

<sup>1</sup> "Cyber Security Primer," University of Maryland, University College, <http://www.umuc.edu/cybersecurity/about/cybersecurity-basics.cfm>, (January 10, 2016)

Over time, domestic and international networks and interconnections have grown, and failure to respond and protect state assets could have severe ramifications on public safety and the state's economy. Accordingly, the increase in cyber threats and limited statutory protections governing electronic information<sup>2</sup> prompted Governor Brown, in August 2015, to sign Executive Order B-34-15.

**California Cybersecurity Integration Center (CSIC).** Executive Order B-34-15 requires the Office of Emergency Services (OES) to establish and lead the California Cybersecurity Integration Center (CSIC). CSIC will be the centralized hub of the state government's cybersecurity efforts and, among other activities, will coordinate information sharing for at least 15 specified organizations.<sup>3</sup> In addition, the Executive Order specifies the Integration Center's other mandated activities:

- Operate with the U.S. Department of Homeland Security – National Cybersecurity and Communications Integration Center.
- Provide warnings of cyberattacks to agencies and non-governmental powers.
- Assess risks to technology networks and protect vulnerable infrastructure and networks.
- Support cybersecurity assessments, audits, and accountability programs required by state law.
- Develop a statewide cybersecurity strategy, as informed by recommendations by the California Task Force on Cybersecurity, which will improve how cyber threats are identified, understood, and shared.
- Establish a Cyber Incident Response Team, the state's primary unit to lead cyber threat detection and coordinate public and private responses with law enforcement agencies.

According to OES, CSIC will be staffed initially in-house, with the current workload absorbed within existing resources. Although beginning coordination efforts have been underway, to date, OES has not yet signed a formal MOU with any of the identified stakeholders.

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<sup>2</sup> Most state laws that make cyberattacks a crime are related to unauthorized computer use and access (Penal Code §502); credit card fraud (Penal Code §484(e)); identity theft (Penal Code §530.5); anti-phishing (Business and Professions Code §22948); cyber-bullying (Penal Code §653.2 and Education Codes §32261,32265,32270, 489000); and notification for breach of computerized data (Civil Codes §1798.29 and 1798.82).

<sup>3</sup> Office of Emergency Services; Department of Technology; California State Threat Assessment Center; California Highway Patrol; California Military Department; Office of the Attorney General; Health and Human Services Agency; California Utilities Emergency Association; California State University; University of California; California Community Colleges; U.S. Department of Homeland Security; U.S. Federal Bureau of Investigation; U.S. Secret Services; U.S. Coast Guard; and other members as designated by the Director of OES.

**Department of Technology (CalTech).** CalTech is responsible for ensuring that nearly 114 state entities maintain the confidentiality, integrity, and availability of their information systems. In addition, CalTech ensures that state entities comply with the policies established. As part of its efforts to protect information assets, the department requires entities to comply with the IT security and privacy policies, standards, and procedures set forth in the State Administrative Manual (SAM). The standards provide the security and privacy policy framework with which state entities must comply.<sup>4</sup> Basically, the state requires that nearly 80 external assessments be conducted on state agency network annually.

**Military Department's Cybersecurity Network Defense Team.** The Budget Act of 2014 provided six permanent positions to the California Military Department's Cybersecurity Network Defense Team (CNDT), which provides network health assessments, website vulnerability scans, and continuous network monitoring. From 2012 to 2014, CNDT, which was funded for \$500,000 per year through a proof of concept grant from the Assembly Speaker's Office, provided assessments to state agencies at no cost to the state agency. Following the termination of the funding, in 2015, the CNDT began providing assessments services to agencies on a fee-for-service basis. Agencies request the CNDT assessment and reimburse the Military Department for the associated costs. Typically, assessments ranged from \$10,000 to \$50,000, and are calculated based on the services requested and the size of the agency.

According to the Military Department, the CNDT uses federal cybersecurity training, paid for by the Department of Defense, to assist state agencies through its access to classified federal cyber intrusion information. In addition, members of the CNDT retain certifications in a wide variety of core commercially recognized cybersecurity competencies, and have reportedly demonstrated their rapid response capabilities and sensitivity for preserving agency confidentiality on multiple occasions.

**Attorney General's eCrime Unit.** In addition to cyber threat prevention, California has taken several steps to investigate and prosecute technology crime, including the establishment of the eCrime Unit in August 2011. The nine-person unit investigates large scale identity theft and crimes with losses in excess of \$50,000. Since August 2011, the unit has filed 111 cases, with 51 cases related to identity theft, 11 of which directly relate to electronic intrusion or hacking. The cases include *People v. Charlie Evens*<sup>5</sup>, in which the accused was determined to have compromised 317 Gmail accounts wherein account holders were tricked into providing a recovery code for their Gmail account. Another example occurred in May 2015, when the former IT Director of Consolidated Tribal Health Project, Inc., in Mendocino County and others were involved in illegally accessing a secure computer system that led to \$65,000 of damages and loss of confidential information from the Consolidated Tribal Health Project. The budget includes \$2 million for the eCrime Unit in the 2016-17 year.

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<sup>4</sup> The standards include 64 different compliance sections; set forth minimum IT security control requirements pursuant to the National Institute of Standards and Technology *Special Publication 800-53* and the *Federal Information Processing Standards*; and reference the *Statewide Information Management Manual*.

<sup>5</sup> *People of the State of California v. Charlie Robert Evens*, Case No. 2486390 (Criminal Complaint, 10 June 2015), [https://oag.ca.gov/system/files/attachments/press\\_releases/complaint%20filed.pdf](https://oag.ca.gov/system/files/attachments/press_releases/complaint%20filed.pdf)

**Other IT policies.** Assembly Bill 670 (Irwin), Chapter 518, Statutes of 2015, requires that 35 agencies receive external cyber security assessments. The Department of Technology and the OES are identifying the 35 agencies in a priority order, with CalTech finalizing the assessment methodology. Once the list and assessment are finalized, the Military Department's CNDT will begin the assessments. AB 670 specifies that agencies pay for the assessments within their existing budgets. The Military Department estimates the assessments to cost about \$40,000 each, depending on the scope of the assessments and the methodology developed by CalTech.

**State Auditor Findings.** A September 2013 State Auditor Report found CalTech's cybersecurity oversight to be a high-risk issue because two of the audited entities (California Department of Corrections and Rehabilitation and the Employment Development Department) inappropriately self-certified to CalTech their compliance with the security standards despite outdated security policies and insufficient risk management programs. The Department of Corrections and Rehabilitation's weaknesses were "deemed too sensitive to release publicly," so the Auditor instead issued a confidential management letter.

In August 2015, the State Auditor released another report, *High Risk Update—Information Security*, which, again, raised questions about CalTech's oversight abilities, specifically:

- **CalTech provided inadequate oversight or guidance.** To determine whether entities have met security standards, the department relies on a self-certification form. The report found, "Until the audit, (CalTech) was unaware that 37 of the 41 entities that self-certified compliance with security standards in 2014, indicated in the State Auditor's survey that they had not actually achieved full compliance in 2014."
- **CalTech did not ensure that entities comply with the state's information security standards.** The State Auditor found 73 of the 77 entities that participated in the survey report that they had "yet to achieve full compliance with the security standards." Because of the nature of its self-certification process, the technology department was unaware of vulnerabilities in these reporting entities' information security controls; thus, it did nothing to help remediate those deficiencies.
- **Constitutional offices and entities in the judicial branch are not subject to CalTech's security standards or oversight.** State law does not require certain state entities, like the judicial branch, constitutional offices, or executive branch entities that are not under the direct control of the Governor, to comply with security standards. Often, these entities maintain some of the most critical services to the state.<sup>6</sup> For example, the State Auditor, in December 2013, reported that the Administrative Office of the Courts' information security documents were "either nonexistent, or in one case, had not been updated since 1997." The Auditor acknowledges that some of these entities may have implemented other security controls in order to comply with other federal laws that govern their programs, but at the time of the report, the Auditor was planning to assess those practices further.

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<sup>6</sup> The State Treasurer's Office finances public works, like schools and higher education facilities. The Department of Justice represents Californians in civil and criminal matters.

**GOVERNOR’S PROPOSAL**

**Department of Technology.** The Department of Technology (CalTech) requests 11 permanent positions and an increase of \$1.6 million General Fund to create a permanent audit unit within the Department of Technology’s Office of Information Security, which will review all departments for compliance with mandated state and federal IT policies. CalTech provides the following chart with the number of IT incidents across state government and the associated financial loss per fiscal year. An incident is defined as any negative event within an IT environment, such as an unplanned event that causes an interruption or outage in service, loss of data, malware infection, risk to personal data, or security breach.

**Incident Chart**

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Number of incidents	1,211	1,778	1,655	1,893	1,762	2,121	2,471
Reported estimate of financial loss associated with incidents	\$1,623,890	\$2,065,056	\$735,810	\$1,725,777	\$2,566,953	\$217,590 (position was vacant – SIMM 5340-B (g) Total Cost of Incident was not recorded for all Incidents)	\$615,195 (position was vacant – SIMM 5340-B (g) Total Cost of Incident was not recorded for all Incidents)

OIS incident report tracking statistics based on incidents reported by state agencies.

**Military Department.** The budget proposes an increase in reimbursement authority from \$774,000 to \$1.4 million, in order to pay for eight permanent positions (six existing positions and two new permanent positions) for the department’s Cyber Network Defense Team. The proposed funding will also fund hardware and software needs to conduct cybersecurity assessments for 35 state agencies.

**ISSUES TO CONSIDER**

**Are we in the right IT hands?** The 2015 State Auditor’s report raised significant questions about the capabilities of certain state departments to effectively and immediately remedy and prevent security lapses for the state’s high-risk assets. Despite the existence of the Task Force that assembles multiple IT professionals and the early development stages of the CSIC, the Legislature may wish to consider how these entities, which are comprised of the very departments that may, themselves, have cybersecurity deficiencies, can lead other departments and effectively respond to incidents. Further, the Legislature should examine and apply lessons-learned from how other entities appear to respond and perform cybersecurity scans and assessments.

**High-risk assets require immediate oversight and security protections.** The Department of Technology believes there is a direct correlation between non-compliance of audits and the occurrence of adverse IT incidents. For example, one state entity reported not performing a risk assessment within the last three years. This same agency had 481 paper breach incidents, resulting in nearly \$270,000 in direct costs. In another example, one state entity had 53 malware

infections, at a cost of \$57,325, due to a lack of basic security controls. These disclosed incidents raise important questions about what other IT vulnerabilities may exist.

CalTech does have an existing pilot audit program that validates the implementation of security controls. However, the State Auditor found that with CalTech's current staffing and completion rate (four auditors complete eight audits every year-and-a-half), it would take "roughly 20 years to audit all reporting entities." It appears that—given the over 200 state agencies and entities—CalTech's existing audit program is too small to address state network vulnerabilities alone. The Governor's proposal appears to take the State Auditor's recommendation into consideration. As such, the Legislature may wish to learn more about this proposal and receive an update from CalTech about how it has incorporated the State Auditor's. In addition, the Legislature may wish to consider how CalTech's proposal fits together with the Military Department's request for its existing, federally-trained and successful CNDT team.

**What happens after a cybersecurity assessment?** The State Auditor's report found the two most frequently cited challenges to achieving compliance were: (1) lack of resources (e.g., inadequate budgets, staff shortages, and a lack of technical expertise); and (2) competing priorities with other day-to-day operations. With the implementation of AB 670, and forthcoming implementation of the CSIC, it is assumed that state departments and agencies will uncover additional needs to secure, or update, their existing IT infrastructure. After an assessment occurs, OES will need work with the Department of Technology's Office of Information Security to remedy security deficiencies, using intermittent external assessments, self-assessments, and audits. Although baseline assessments are helpful to identify initial needs, the Legislature should consider how departments and state agencies will address additional, new challenges, given that some entities already do not comply with existing security standards.

**Patterns in types of cybercrimes.** The Attorney General's eCrime Unit found a continuing increase in both organized and unorganized criminal elements systemically attacking data storage systems in order to leverage stolen information for profit. Given the quickly evolving nature of technology and cyber attacks, the Legislature may benefit from technological expert testimony on how the state can apply learned themes and best-practices to avoid certain types of crimes and vulnerabilities.

**Monitoring Implementation of the CSIC and inter-departmental coordination.** According to OES, to date, CSIC stakeholders have met to determine resources required for the 24/7 operations of the Center, but to date, no formal MOU has been established. The Legislature may wish to conduct ongoing oversight of the implementation of the new Center during subcommittee hearings.

# Regulating Medical Marijuana

## BACKGROUND

The statutorily authorized use of medical marijuana in California dates back to November 1996, when voters passed Proposition 215, the Compassionate Use Act of 1996 (CUA). The CUA provides certain Californians the right to obtain and use marijuana for medical purposes, as recommended by a physician; and, prohibits criminal prosecution or sanction against physicians who make medical marijuana recommendations.<sup>1</sup> In 2003, Senate Bill 420 (Vasconcellos), Chapter 875, Statutes of 2003, established the Medical Marijuana Program under the California Department of Public Health, and created a medical marijuana identification card and registry database to verify qualified patients and primary caregivers. Participation in this identification program is voluntary.

Since 2003, advocates, patients, and local governments recognized some deficiencies in the oversight of medical marijuana and called for additional safety regulations. In June 2015, Governor Brown signed the Medical Marijuana Regulation and Safety Act, comprised of Assembly Bill 243 (Wood), Chapter 688, Statutes of 2015; Assembly Bill 266 (Bonta), Chapter 689, Statutes of 2015; and Senate Bill 643 (McGuire), Chapter 719, Statutes of 2015. Together, these bills established the oversight and regulatory framework for the cultivation, manufacture, transportation, storage, and distribution of medical marijuana in California. Below is a chart that summarizes the various provisions across departments.

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<sup>1</sup> Health and Safety Code §11362.5

**Medical Marijuana Regulation and Safety Act  
Responsibilities by Department**

<b>Department</b>	<b>Tasks</b>	<b>Statute</b>
Department of Consumer Affairs	License dispensaries, distributors, and transporters.	BPC <sup>1</sup> 19334
Department of Fish and Wildlife	Expand its pilot project to address the Environmental Impacts of Cannabis Cultivation and continue enforcement efforts.	Water Code 13276(a)
State Water Resources Control Board	Authorized to address waste discharge by adopting a general permit.	Water Code 13276 (b)
Department of Food and Agriculture	Establish regulations for the licensing of indoor and outdoor cultivation sites.	BPC 19332(a)
	Ensure water diversion and discharge from cultivation doesn't affect instream flows for fish spawning, migration, or rearing.	BPC 19332(d)
	Establish a Medical Cannabis Cultivation Program, with specified criteria.	HSC <sup>2</sup> 11362.777
	Establish program that identifies a permitted medical marijuana plan by a unique identifier.	HSC 11362.777
	Develop a separate "track-and-trace" system to report movement of commercial products through distribution chain.	RTC <sup>3</sup> 31020
Department of Public Health	Develop regulations for producing and labeling of edible cannabis products.	BPC 19332(c)
	License cannabis manufacturers and testing laboratories.	BPC 19341
Department of Pesticide Regulation	Develop cultivation regulations for pesticide use.	BPC 19332(b) and (f)

<sup>1</sup> Business and Professions Code.

<sup>2</sup> Health and Safety Code.

<sup>3</sup> Revenue and Taxation Code.

**Application, licensing, and renewal process and fees.** An applicant for any type of state marijuana-related license must first submit electronic fingerprints to the Department of Justice and provide evidence of the legal right to occupy and use the proposed location. Under the state law, each licensing authority must establish a scale of application, licensing, and renewal fees. The licensing and renewal fees are calculated to cover the costs of the program administration, and are set on a scaled basis depending on the size of the business. All fees are deposited into an account specific to that licensing authority, which will be established within the Medical Marijuana Regulation and Safety Act Fund.

**Penalties and violations.** State law authorizes a civil penalty of up to twice the amount of the license fee for each violation, and the department, state, local authority, or court may order the destruction of the medical marijuana associated with the violation. Civil penalties are deposited into the Marijuana Production and Environment Mitigation Fund. The law also establishes different locations for where the penalties will be deposited, depending on whether the Attorney General, district attorney or county counsel, or a city attorney or city prosecutor brings forth the action. Fines and penalties levied on licensees must be placed in the Medical Marijuana Fines and Penalties Account to establish a grant program for state and local entities for the purposes of assisting with medical cannabis regulation, enforcement, and environmental remediation.

**Local control and planning.** A city or county must notify the Department of Food and Agriculture if it issues or denies conditional licenses to cultivate medical marijuana. A city or county may also issue or deny a permit to cultivate medical marijuana, subject to certain restrictions. For example, any proposed cultivation site or dispensary must be at least a 600-foot radius away from a school.

**Reporting requirements.** Starting March 1, 2023, each licensing authority must prepare and submit a report to the Legislature about its activities, including the amount of funds spent for licensing, enforcement, and administration; the number of licenses issues, renewed, denied, suspended, or revoked; average time for processing applications; number and type of enforcement activities conducted; and the number, type, and amount of penalties, fines, and other disciplinary actions taken.

**Privacy protections.** Except as necessary for review, patient names, medical conditions, and names of primary caregivers are prohibited from being disclosed pursuant to the California Public Records Act. The information will be treated as confidential patient information and will be maintained in compliance with state and federal law.

**GOVERNOR'S PROPOSAL**

The budget includes an initial loan of \$5.4 million to the Medical Marijuana Regulation and Safety Act Fund, which will, in the future, be the repository for all fees collected by the licensing authority. In addition, the budget includes \$12.8 million General Fund, \$10.6 million Medical Marijuana Regulation and Safety Act Fund, \$1.2 million special funds, and a proposed 126 positions to implement the regulations. To comply with the new requirements and standards set forth by the act, the budget includes several proposals across different departments, including:

- **Department of Fish and Wildlife.** The budget includes \$7.7 million General Fund and 31 positions to make permanent the 2014 multi-agency task force.
- **State Water Resources Control Board.** The budget includes \$5.7 million (\$5.2 million General Fund and \$472,000 Waste Discharge Permit Fund) and 35 positions in the budget year for the Board to develop and implement a program that addresses environmental impacts of cultivation, as well as protecting fish from possible water diversions related to cultivation.
- **Department of Food and Agriculture (CDFA).** The budget proposes \$3.3 million in 2015-16 and \$3.4 million from the Medical Marijuana Regulation and Safety Act Fund, and 18 positions in the budget year, to provide administrative oversight for the Medical Cannabis Cultivation Program, establish regulations, issue medical marijuana cultivation licenses, and perform an Environmental Impact Report. Also, the CDFA will establish a “seed-to-sale” program to report the movement of products throughout the distribution chain.
- **Department of Consumer Affairs.** The budget includes \$1.6 million in the current fiscal year and \$3.8 million from the Medical Marijuana Regulation and Safety Act Fund, as well as 25 positions in the budget year, to create the Bureau of Medical Marijuana Regulation within the Department of Consumer Affairs.
- **Department of Public Health.** For licensing and regulation of medical marijuana product manufacturers and testing laboratories, the budget includes \$457,000 in 2015-16 and \$3.4 million from the Medical Marijuana Regulation and Safety Act Fund, and 14 positions in the budget year.
- **Department of Pesticide Regulation.** To assist in the development of guidelines of pesticide use in medical marijuana cultivation, the budget proposes \$700,000 to the Department of Pesticide Regulation.

For additional information, please see page 2-9 under the Natural Resources section of this publication.

## ISSUES TO CONSIDER

**Monitoring state implementation.** The newly established Bureau of Medical Marijuana Regulations, along with other licensing entities, will be responsible for 17 different types of business licenses, including: cultivators, nurseries, processors, testing labs, dispensaries, and distributors. Regulations are required to be released by January 1, 2018. To meet this deadline, the Department of Consumer Affairs (DCA) has already held meetings with other licensing entities, and has educated staff and the public about the new law, including: holding educational tours of cannabis businesses, seeing demonstrations on the Track and Trace systems, and receiving expert presentations. DCA has also compiled a list of interested parties, such as cannabis industry associations, local governments, state agencies, and labor groups, who are interested in participating in the regulatory process. However, to date, no formal stakeholder meetings have been held. Given the impending two-year deadline, and that there is no recent precedent for establishing an oversight and regulatory scheme of this magnitude,<sup>2</sup> the Legislature may wish to consider the following oversight questions during the subcommittee process:

- How will DCA include and inform the Legislature on the status of regulations?
- Since each department's proposal provides a different implementation timeline, how will DCA coordinate across the different licensing entities to ensure regulations are developed on-time, and with appropriate and adequate staffing levels?

**Governance structure.** Within the Department of Consumer Affairs, there are over 40 boards and bureaus. The governance structure of a board and bureau varies. For example, the Medical Board is comprised of 15 members – eight physicians, five public members appointed by the Governor, and two public member appointments by the Assembly Speaker and the Senate Rules Committee. In contrast, the Bureau of Automotive Repairs has one chief, along with other executive staff, who reports to the DCA Director and serves at the pleasure of the Governor as an appointee. Whenever a change in the office of Governor occurs, the chief of this Bureau of Medical Marijuana Regulation may be aligned with the sitting Governor's views on marijuana. The Legislature may wish to consider whether the governance structure of a bureau could withstand political shifts, so as to prevent any adverse impacts on licensees.

**Possible impact by future initiatives.** In 2010, around 54 percent of California voters cast “no” votes for Proposition 19 (2010), which sought to further legalize marijuana. This year, a title and summary for over ten marijuana legalization proposals are being circulated for signature. Should an initiative qualify for the November 2016 ballot, and should voters approve the legalization of recreational marijuana, how will the various budget proposals be implemented to address any new recasting of marijuana?

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<sup>2</sup> The last bureau to be created under DCA was the Professional Fiduciaries Bureau, established in 2007, which only licenses approximately 600 individuals.

**Marijuana remains a Schedule 1 controlled substance.** Since 1970, the federal Control Substances Act defines Schedule 1 drugs as those that have a high potential for abuse; have no currently accepted medical use in treatment; and possess a lack of accepted safety under medical supervision. Marijuana is considered a Schedule 1 drug, along with heroin, ecstasy, and LSD. States maintain a similar classification list, with the possibility that state and federal lists may conflict; however, in California, there is no such conflict.<sup>3</sup> Given that both federal and state classifications consider marijuana a Schedule 1 substance, the Legislature may wish to consider how these long-held policies may influence, and may create tensions, in how local cities, counties, or law enforcement view and enforce medical marijuana enterprises under the new regulations.

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<sup>3</sup> Health and Safety Code §11054 (d)(13)

## 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 California 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, one exception to this is payment of costs related to labor relations-related mandates, which may be deferred while still retaining the mandate's requirements.<sup>1</sup>

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 2014-15 are reported and claimed in 2015-16, and the state will reimburse locals for these costs as part of the 2016-17 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 \$1.0 billion in non-education mandate payments. All of this is related to post-2004 mandate claims.

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<sup>1</sup> Payments for mandate costs incurred prior to 2004 were allowed to be repaid over time, and statutorily required to be fully paid by 2020-21. As of December 2015, the pre-2004 mandate debt (pursuant to Government Code Section 17617) was paid off as a result of appropriations made in the 2014 Budget Act.

**GOVERNOR'S PROPOSAL****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 \$45.6 million related to funding non-education mandates. The budget would continue to fund the 16 mandates that were kept in force for 2015-16, the payments on which constitute the bulk of the General Fund cost. In addition, the budget proposes funding a payment of \$7.6 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 \$11,000 to fund the Medi-Cal Eligibility of Juvenile Offenders mandate and \$725,000 to fund the State Authorized Risk Assessment Tool for Sex Offenders mandate. Most mandates funded in the budget concern public safety or property taxes. Funded mandates are listed in the following table.

**Mandate Funding in Governor's Budget  
General Fund  
(Dollars in Thousands)**

Mandate Title	Amount
Accounting for Local Revenue Realignments	\$97
Allocation of Property Tax Revenue	611
California Public Records Act	7,578
Crime Victim's Domestic Violence Incident Reports	166
Custody of Minors-Child Abduction and Recovery	13,328
Domestic Violence Arrests and Victim's Assistance	2,725
Domestic Violence Arrest Policies	8,494
Domestic Violence Treatment Services	2,019
Health Benefits for Survivors of Public Safety Officers	2,943
Medi-Cal Beneficiary Death Notices	26
<i>Medi-Cal Eligibility of Juvenile Offenders</i>	11
Peace Officer Personnel Records	548
Rape Victim Counseling	353
Sexually Violent Predators	5,129
<i>State Authorized Risk Assessment Tool for Sex Offenders</i>	725
Threats Against Police Officers	263
Tuberculosis Control	83
Local Agency Ethics	0
Unitary Countywide Tax Rates	456
<b>Total</b>	<b>\$45,555</b>

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

**Budget Savings**

The budget incorporates a total of \$884.8 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) \$260.3 million savings from deferring payment of post-2004 mandate claims for mandates that have since expired or are otherwise not in effect; (2) \$607.6 million savings by continuing the suspension of certain local mandates; and, (3) \$16.9 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.

**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.

**Carry-Over Debt**

As indicated, as part of its debt reduction plan, the Administration has paid off the pre-2004 mandate amounts owed to local government prior to the required date of 2020-21 required by the Constitution. However, the state has accrued considerable debt on mandates that were in effect during the period after 2004. Some \$1.1 billion is owed to local governments for these post-2004 mandates, including \$248.1 million for Handicapped and Disabled Students, \$154.9 million for Crime Statistics Reports for Department of Justice, and \$109.8 million for Open Meetings Act. The Administration has not put forward a plan to address these amounts owed; the absence of such a plan could begin to exacerbate state-local government relations.

**Delays in the Process**

Significant progress has been made in the time expended in the mandate 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, another year to adopt the mandate's claiming methodology, and almost another year to estimate the costs and report the mandate to the Legislature. This time has been reduced due to the additional resources and strong efforts on the part of Commission staff. However, the process remains time-consuming and any 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.

The state could deal with fiscal uncertainty by conducting an initial legal analysis of the potential mandate, carry-out a preliminary cost estimate, and annually pre-fund the mandate pending a final determination. A recent statute provides a template for this approach. Last year, the Governor signed Assembly Bill 953 (Weber), Chapter 466, Statutes of 2015, which revises the definition of racial profiling and, among other things, requires the Attorney General to report on citizens' complaints alleging racial or identity profiling. Beginning in 2018-19, local agencies will be required to report data on all stops conducted by the agencies' peace officers, including the time, date, location, and justification. The budget includes \$10.0 million in anticipation of state costs in the likely event that at least a portion of the statutory requirements are determined to be a reimbursable mandate.

### **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.

**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. To date, a comprehensive plan to improve the mandate process overall has not been provided to the Legislature; however, in the elections mandate area, DOF, LAO and the Secretary of State's Office are in the midst of an effort to work with local governments to establish an alternative means to address these mandates that would incur lower costs while retaining their overall intent. The report of this group is due in September 2016.

# California's Earned Income Tax Credit

## BACKGROUND

As a component of the May Revision last year, the Governor proposed an Earned Income Tax Credit (EITC) for the state's low income-wage earners. The proposal for a state-level EITC has been discussed, debated and proposed by the Legislature for a number of years; just since 1999-2000, eight bills have been proposed to adopt a California EITC. The Governor's proposal, which was included in the May Revision last year, was based largely on one of several options developed by the Legislative Analyst's Office (LAO) earlier in the year. After incorporating some changes proposed through the legislative process, the EITC was included in the final 2015-16 budget. California's EITC is largely modeled on a similar federal credit, but with some important distinctions, as noted below.

### California EITC Program Design

Budget trailer bill legislation passed by the Legislature and signed by the Governor last year created the EITC—a state refundable tax credit for wage income that is intended to benefit very low-income households. Specifically, the program builds off the federal EITC and establishes a refundable credit for tax years beginning on or after January 1, 2015. The credit is applied to personal income tax liabilities associated with earned wage income (not including self-employment income). The program provides for a credit amount during a phase-in range of earned wage income according to specified percentages based on the number of qualifying children. The phase-in range (for the maximum credit) covers earned wage income of up to \$3,290 for individuals without qualifying children, \$4,940 for individuals with one qualifying child, and \$6,935 for individuals with two or more qualifying children.

California's EITC focuses on households with incomes less than \$6,580 if there are no dependents and up to \$13,870 if there are three or more dependents, with no tax credits earned for wages received above these thresholds. The California program dovetails with the existing federal EITC and matches 85 percent of the federal credits, up to half of the federal phase-in range, and then begins to taper off relative to these maximum wage amounts. The credit is expected to cost \$380 million annually beginning in 2015-16 and benefit an estimated 825,000 families and two million individuals. The estimated mean household benefit is \$460 per year, with the median benefit likely to be in the range of \$200 to \$250 per year. Maximum credit amounts available range from \$214 for participants with no qualifying dependents, to \$2,653 for participants with three or more qualifying dependents. The Franchise Tax Board (FTB) administers the EITC program.

### Characteristics of California EITC

With the adoption of the EITC, California joins 25 other states in offering a state-level program for the working poor. Although some variations occur in the design details of individual state programs, all states' programs are based on a percentage of the federal credit. These programs typically match a percentage of the federal credit across the income spectrum that is eligible for

the federal credit—that is, during the phase-in range, flat range, and phase-out range. Two major features set California’s credit apart from those of most other states, as discussed below:

- First, as opposed to matching a set percentage of the federal EITC across the eligible income range, California matches a percentage of the federal credit over just a portion of the federal EITC phase-in range. Specifically, the state program matches 85 percent of the federal EITC amounts up to half of the federal phase-in range and then begins to phase out; California’s EITC is fully phased-out when the federal credit reaches its maximum amount. By way of comparison, New York—which has had its own EITC since 1994—offers a refundable state EITC that is pegged at 30 percent of the federal EITC amount over the entire eligible income range. The design of the California credit limits the fiscal exposure to the state and allows for the concentration of available dollars on lowest income earners at a higher credit level.<sup>1</sup>
- Second, California’s EITC is not an automatic entitlement. The program is only available if the Legislature and Administration affirmatively determine each year that the state can afford the program. Annually, the state is required to set the adjustment factor (initially set at 85 percent) to determine the amount of the actual credit and specify this in the annual budget act. Unless otherwise specified, the adjustment factor will default to zero percent. This feature distinguishes the state EITC from expenditure programs like CalWORKs, but also various special tax programs, which typically operate unrestrained by legislation or budget action (except through a two-thirds vote of the Legislature).<sup>2</sup>

### **EITC Program Impacts**

The federal EITC is an unusual assistance program for low-income wage earners in that it generally receives favorable views from economists and policy analysts from across a wide political spectrum. Some view it favorably as a program that shifts resources to lower income households and individuals and acts to lift some populations out of poverty. Others support the program due to the work incentives that are imbedded in the program design. In general, these dual qualities of the program have constituted much of the motivation to adopt similar programs at the state level.

The design of the EITC is relatively straightforward; however, the impacts of the EITC—conceptually and empirically—are far from simple or unambiguous. In particular, the work incentives of the program depend on numerous factors, including whether the recipient is in the phase-in or the phase-out range, marital status and the presence of a second worker, and interactions with prevailing wages or social welfare programs. For example, theoretically and empirically, the program would result in a work incentive (by increasing the hourly return) during the phase-in period and have no impact on work incentive during the flat phase. Over the phase-out range, theory would suggest that there would be a work disincentive; empirically,

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<sup>1</sup> The difference in fiscal impacts is significant. New York’s EITC results in an expenditure/revenue reduction of \$994 million annually (on a personal income tax base of \$38 billion), whereas California’s EITC is expected to result in an expenditure/revenue reduction of \$380 million (on a personal income tax base of \$78 billion).

<sup>2</sup> For many tax programs, this annual uncertainty would tend to inhibit the very behavior the tax program is designed to encourage. For example, a research and development tax credit that was subject to annual fiscal assessment and budget decisions could undermine the intent to stimulate long-term investments in research and development. Similarly, subjecting the EITC to annual budget appropriations would potentially subvert the intended work incentive of the program.

however, the actual impact on work hours appears to be slight. Overall the range of program eligibility, the work incentive is (almost) never negative,<sup>3</sup> but during the phase-out range, the incentive to work is reduced for every additional dollar earned. The design of the California program is such that it phases-out while the federal program is still phasing-in, thus avoiding the disincentive that occurs with respect to the federal program during its phase-out period.

## CURRENT POLICY AND GOVERNOR'S PROPOSAL

The state's EITC was adopted as part of the current year's budget and is effective beginning with the 2015 tax year. The Department of Finance (DOF) estimates the program as structured will result in expenditures and forgone revenues of \$380 million annually. The Governor has not proposed any additional components to the program.

## ISSUES TO CONSIDER

The Governor's budget does not propose additional changes to this program; however, during legislative deliberations, a number of important policy issues were raised—each with significant budget impacts. Given this, the Legislature may want to consider these issues in the context of its consideration of various income support and social welfare programs.

### Annual Budgetary Appropriation

California has a significant number of tax programs that are designed to accomplish a variety of goals. Generally, for personal income taxes and corporation taxes, these tax programs include tax credits, income deductions or other special tax treatment. The programs are typically designed either to encourage particular types of behavior or provide generalized tax relief. The research and development (R&D) tax credit—available under the personal income tax and the corporation tax—is an example of the former, while the dependent exemption credit—available under the personal income tax—is an example of the latter.<sup>4</sup>

Until recently, virtually all of California tax programs were not subject, through statute or other means, to any cost limitation. Given that such special tax treatment is considered to be a matter of legislative grace, the programs could always be limited or eliminated by the Legislature; however, this would require a two-thirds vote since it would result in an increase in the tax burden on a taxpayer. In recent years, the Administration and the Legislature have become more circumspect about the granting of tax preferences, with recent programs subject to either allocation through an annual cap on credits or by means of a sunset date. There is also some past experience with programs that automatically 'trigger' off if a specified event occurred. The former manufacturer's investment credit (MIC) is an example of this.

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<sup>3</sup> One exception is the area in which the participant loses eligibility for certain programs such as California Work Opportunity and Responsibility to Kids (CalWORKS), CalFresh (formerly food stamps) and California Medical Assistance (Medi-Cal). The loss of these programs due to increased earnings can place the household in a negative marginal position with respect to additional work.

<sup>4</sup> See the write-up "*California Tax Expenditure Programs*" in this publication for a full discussion of the state's special tax programs.

These approaches are a means to simultaneously limit the state's fiscal exposure, deal with the asymmetry of voting requirements,<sup>5</sup> and facilitate an evaluation of the program's effectiveness. With the EITC, the state has instituted a new means of ensuring protection of the state's fiscal condition. Under the measure, the Administration must annually set the adjustment rate which determines the amount of the tax credit, with an effective rate of zero if no other rate is specified. This approach differs from virtually all other state tax programs, and creates substantial uncertainty for individuals and households that participate in the program.<sup>6</sup> Other than the few programs adopted in recent years, all other state tax programs change independently of state budget considerations.

The Legislature might consider the following reforms that address these issues:

- First, the Legislature could change the law to simply place the EITC on par with the vast majority of other special tax programs by establishing a positive non-zero adjustment factor (at a specified rate) in statute and allow the program to expand (or contract) as determined by eligibility standards.<sup>7</sup> A rate lower than 85 percent could be selected, in order to provide additional fiscal protection to the state. This rate could always be enhanced should fiscal conditions permit and legislative prerogatives dictate.
- Second, if some additional fiscal limits were deemed advisable, the Legislature could establish in statute a specified adjustment rate for a certain period of time, for example, a five year period. This approach would provide some certainty to participants in the program, but also provide some fiscal protection to the state in the event of an economic downturn or other source of budgetary stress.

There are also a number of other permutations to these alternatives that would be a means of making the program more useful to potential participants while still providing more fiscal certainty to the state than it is provided under the vast majority of tax preferences available to other taxpayers.

### **Self-Employment Income**

Under the adopted program, income eligible for calculating the amount of the EITC is limited to salaries and wages that are subject to withholding. In particular, self-employment income is not considered as part of earnings eligible for the EITC. The principal reason for this exclusion, according to the Administration, is the potential for large amounts of improper payments to participants who claim a larger credit than for which they are eligible. One of the primary means by which to misrepresent income—based on the federal experience—is through the misreporting

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<sup>5</sup> Enacting a special tax preference (reducing taxes) requires only a majority vote whereas eliminating or limiting a tax preference (increasing taxes) requires a 2/3rds super-majority vote.

<sup>6</sup> One of the hallmarks of a good tax system is that provides certainty to taxpayers and avoids short-term, sudden or capricious adjustments that can affect liabilities. An annual budget decision that affects tax liabilities (even negative liabilities) runs counter to this. Some argue that EITC participants lack the sophistication to track such consistency; however, it seems questionable to ignore basic tax policy because taxpayers affected might lack sophistication.

<sup>7</sup> While this would not provide the automatic fiscal protection in current law, the Legislature could still change the rate if fiscal conditions necessitated this (such as when the Legislature suspended the ability of businesses to use the net operating loss provisions during the past recession).

of self-employment income. Unlike self-employment income, wages and salaries incorporate a more comprehensive paper trail to verify income.<sup>8</sup>

The federal EITC, by contrast, includes self-employment income in the EITC definition of income. The federal program includes as income:

- Wages, salaries, tips, and other taxable employee pay.
- Union strike benefits.
- Long-term disability benefits received prior to minimum retirement age.
- Net earnings from self-employment.

Unlike California's approach, most other states with an EITC mimic the federal income eligibility standards. California's approach to ensure the reliability of payments is a fiscally reasonable approach, in that it helps ensure the program retains its integrity and only benefits those for whom the program was designed. On the other hand, many low-income earners have part-time occasional employment that results in income that is not subject to withholding. In fact, it is more than likely that some otherwise eligible individuals may rely solely on such income and thus are precluded from participating in California EITC program altogether.

During the legislative discussion, the possibility of including self-employment income was raised, but resisted by the Administration. In response, the Legislature required that the FTB, which administers the program, issue a report on the feasibility of including such income in the earned income calculation. The report requirement is in supplemental language and states:

*No later than January 10, 2016, the Franchise Tax Board (FTB) shall provide to the chairs of the Joint Legislative Budget Committee and the chairs of the fiscal committees of both houses of the Legislature, a report on the status to date of implementation of the state Earned Income Tax Credit (EITC) program. This report should discuss the current status of (a) necessary changes to existing tax forms and the creation of new tax forms, if any, to implement the state EITC (b) training of FTB telephone and live chat help center staff to respond to tax filer and preparer questions about the state EITC, (c) education and outreach efforts regarding the federal and state EITCs, (d) updates to the [ftb.ca.gov](http://ftb.ca.gov) and [taxes.ca.gov](http://taxes.ca.gov) websites to disseminate information about the state EITC, and (e) the readiness of return processing infrastructure to accept and process returns claiming the state EITC. After implementation activities have been completed for the California EITC, the FTB shall explore methods that could be considered to allow self-employment income to be included as earned income while protecting against improper payments. This information shall be provided to staff of the budget committees.*

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<sup>8</sup> Independent contractor income may be reported on a Form 1099, but the enforcement of this requirement is spotty and the resulting data often incomplete, inaccurate or missing.

The FTB indicates that the report regarding self-employment income will be completed and submitted to the Legislature by April 30, 2016. Based on the considerations and issues developed in this report, the Senate may consider measures that would broaden the earned income definition used for the EITC. This would have the dual effect of expanding the program to include currently ineligible individuals as well as increasing the credit for some who currently participate in the program. This consideration would entail, in part, weighing the benefits of expanding the scope of the program against any potential increase in abuse of the tax program.

### **Periodic Payments**

Like the federally-sponsored EITC, California's EITC is structured and administered through the tax system. Any EITC amount due to a participating individual is remitted as a refund or payment pursuant to an annual state income tax return filing. There are numerous advantages to such an approach. For example, the administrative costs and complications are minimized by using an already-established framework and potential abuses are likely to be constrained. In addition, the one-time payment facilitates 'forced' savings or, alternatively, allows recipients to purchase larger necessities such as car repairs or appliances.

There are drawbacks to this annual payment approach, however. With respect to the intended work incentive, a single lump sum is more likely to be perceived by participants as a simple income transfer as opposed to a wage subsidy with a direct link to work participation, thus potentially weakening the work incentive effect. In addition, while the program may force savings, it does so at the expense of consumer preferences, preventing a participating household from relying on the subsidy for regular budgeting purposes. Finally, the annual payment facilitates an outflow of benefits to commercial tax preparers that charge interest on refund anticipation loans on EITC participants' tax filings.

One option to the annual payment is some version of periodic payment approach. This alternative has been explored through research, pilot projects, and at the federal level. For example, beginning in 1978, the federal EITC had an optional program whereby EITC participants notified their employer that they were eligible for the EITC. The Internal Revenue Service (IRS) then conducted a preliminary approval process and calculated the amount of the eligible subsidy to be included in the participant's regular paycheck. The additional pay was financed by employers by reducing the amount of their withholding and tax payments to the IRS.

For various reasons, the periodic payment program was severely undersubscribed and was discontinued by Obama Administration as part of the 2010 budget. According to a General Accounting Office (GAO) report, the program utilization was low for three primary reasons: 1) general lack of awareness by participants; 2) the possibility of repayment liabilities in the event of an overpayment; 3) a preference among participants for a lump sum payment. In addition, this option suffered from some compliance problems, according to the IRS.

Since the discontinuation of the federal program, there have been additional proposals regarding a periodic payment system. The Chicago EITC Periodic Payment Pilot, administered by the Center for Economic Progress and the city government, involves a program that pays participants one-half of their anticipated EITC in four installments of the course of the year. Unlike the federal program, the payments are made directly rather than included in the participants'

paychecks. According to preliminary indications, the program has been administered successfully, with a very small percentage of participants in an overpayment situation. In addition, the program has resulted in reduced fiscal stress for the participants (compared to the control group) as measured by debt accumulation, interest payments and late fees. There are numerous other periodic payment versions that could be adapted to serve California's needs.

An overarching issue regarding this alternative is which entity would best be in a position to effectively administer a periodic payment program. This could be the FTB but could equally be assigned to an agency with more specific knowledge of the identified population. An effective periodic payment system would require addressing the following administrative components:

- **Enrollment.** Enrollment entails identifying and recruiting potential participants in an EITC periodic payment program and then verifying their eligibility to participate based on a set of objective factors.<sup>9</sup>
- **Disbursement.** Disbursement involves identifying the entity responsible for the disbursement (e.g. financial institution or tax agency) as well as the frequency of the payments to the participating individual.
- **Communication.** Communication ensures that inaccuracies inherent in an income supplement program (such as income changes or "life" changes) can be corrected midstream, thus minimizing the monetization of these errors.
- **Reconciliation.** Reconciliation involves the year comparison of advanced payments and final credit amount eligibility, which could occur in conjunction with the filing of the annual tax return with the FTB.

Development of a periodic payment system would require substantial development at the state level. On the other hand, the benefits to participants could be a significant means of improving the impact of the state's modest program investment. A starting point could be an assessment of both the need and the demand for such a program. For example, for the 2012 tax year, five states (Georgia, Florida, Massachusetts, Minnesota and New York) included with their EITC application process a series of questions designed to obtain information about these issues. They included questions regarding: desirability of advance and deferred periodic payments; preferred payment frequency; participants' most fiscally stressed months; and households' ability to meet an unexpected payment or fee.

California's current EITC program is an important—though rather modest—investment in improving the economic situation of the state's low-income wage earners. The Legislature may want to consider expanding, broadening and improving the program as one of the means to improve the outlook for this population, and, in this process, consider further actions and potential pilot projects with respect to the alternatives presented here.

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<sup>9</sup> Eligibility could include criteria that would tend to reduce the chances of potential fraud, including past tax records, presence of unearned income or other resources, and existence of any obligations such as child support.

# Tax Expenditure Programs

## BACKGROUND

### Background

California's General Fund revenue system is based almost entirely on three principal taxes, which together constitute approximately 98 percent of the state's revenue base. For the upcoming budget year, the Legislative Analyst's Office (LAO) forecasts the following revenue levels (percent of total):

- Personal Income Tax—\$84.3 billion (68 percent).
- Sales and Use Tax—\$25.6 billion (21 percent).
- Corporation Tax \$10.7 billion (9 percent).

The primary purpose of the state's revenue system is to provide the resources necessary to support various publicly-provided goods and services to state residents. However, in designing the tax system (and maintaining its current structure), policy-makers inherently address many other issues, including, but not limited to: taxpayers' ability to pay, state tax burden, economic efficiency, interstate competitiveness, overall fairness, and administrative feasibility.

### Special Tax Treatment

In consideration of these various economic, income, and fiscal issues, California's tax system has incorporated numerous special tax programs. Such special tax programs have become commonly known as tax expenditure programs (TEPs). The use of this term is based on the premise that these programs involve the "expenditure" of revenues, otherwise received by the state, for the benefit of particular classes of identified taxpayers. 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.

The definition of a TEP can be a tricky business, but in general the term refers to tax exclusions, exemptions, preferential tax rates, credits and other provisions that reduce the amount of revenue otherwise collected by the state's 'basic' tax structure.<sup>1</sup> California's multitude of TEPs results in reduced liabilities for certain taxpayers and higher liabilities

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<sup>1</sup> The term 'basic' in describing a tax structure is a key discussion point. For example, while the state's progressive rates are generally considered part of the basic tax structure, some would argue that these brackets constitute a TEP, to the extent that such rates diverge from the average tax rate. This perspective would logically entail defining a negative TEP (for tax rates that exceed the average). Similarly, some consider the exemption of services to be a sales and use tax TEP, but generally the base of the sales and use tax base is considered to be tangible personal property, which would preclude non-taxation of services and intangible property as a TEP.

(than would otherwise occur) for all other taxpayers. Conversely, the elimination of, or the reduction in, a TEP would allow for a broad-based reduction in taxes for all taxpayers while maintaining the same level of revenue for the state.

State TEPs are of two general types; (1) those designed to give taxpayer relief, and (2) those that provide an incentive for certain behavior. The sales and use tax exemption for food, and the personal income tax dependent exemption credit, are examples of the former type of TEP. The R&D expenses tax credit available under the personal income tax and the corporation tax, and the mortgage interest deduction under the personal income tax, are examples of the latter type of TEP.

## BUDGET IMPACTS

State enactment of TEPs has direct and significant impacts on the state budget, through a reduction in revenues that would otherwise be collected. The state's major income taxes (personal income tax and corporation tax) incorporate numerous TEPs that result in special treatment for individuals or businesses, based either on situational factors or for engaging in certain activities. Income tax related TEPs largely come in the form of tax credits (a direct reduction in tax owed) and income deductions (a reduction in income subject to tax). Certain other income tax 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. With respect to TEPs related to personal income taxes, the Department of Finance (DOF)—one of the four state agencies that compile TEP-related reports—estimates the annual revenue impact to be about \$40 billion.<sup>2</sup> For corporation taxes, the revenue impact total is about \$5 billion.

The state and local portions of the sales and use tax also offer special tax treatment for the purchase of particular items as well as the purchase of items by particular buyers. For sales and use taxes, TEPs are typically exclusions or exemptions from the imposition of the tax. In addition, TEPs for the sales and use tax could include certain special treatment, such as a partial exemption or special tax treatment for the seller of a product. The DOF estimates that the General Fund portion of foregone revenues for sales and use tax TEPs is roughly \$12 billion annually. Thus, the aggregate amount of the individual impacts of the state's TEPs for 2015-16 is about \$57 billion, or roughly 47 percent of General Fund revenues.<sup>3,4</sup> The state's largest TEPs are listed in the following table.

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<sup>2</sup> In addition to the annual report issued by the Department of Finance, the Legislative Analyst's Office provides periodic reports on policy motivations, effectiveness and annual revenue costs of selected TEPs. The Franchise Tax Board issues an annual report regarding personal income and corporation tax TEPs and the Board of Equalization compiles an annual TEP report on the range of taxes it administers.

<sup>3</sup> These 'static' estimates account for how changes in tax policy might cause households and businesses to substitute lightly taxed activities for more heavily taxed ones (i.e., the direct behavioral response to the tax). The estimates do not generally account for secondary or indirect impacts or the overall impact on the aggregate economy. Nevertheless, most tax analysts consider such first order estimates as reasonable approximations.

<sup>4</sup> Note that while this aggregate number provides an order of magnitude of the universe of TEPs, it is not equivalent to total revenues that would be raised if the TEPs were eliminated, because of interactions

**Largest General Fund Tax Expenditure Programs  
2015-16 Estimates  
(Dollars in Billions)**

<b>Tax Expenditure Program</b>	<b>Type of Tax Expenditure</b>	<b>Tax Program</b>	<b>Revenue Impact</b>
Employer Paid Health Care	Exclusion	Personal Income	\$6.1
Food Products/Bottled Water	Exemption	Sales and Use	5.6
Employer Paid Pensions	Exclusion	Personal Income	5.0
Mortgage Interest	Deduction	Personal Income	4.8
Social Security Benefits	Exclusion	Personal Income	3.4
Capital Gains on Home Sale	Exclusion	Personal Income	3.0
Charitable Contributions	Deduction	Personal Income	2.9
Basis Step-Up on Inheritance	Exclusion	Personal Income	2.6
Gas, Electricity, Water	Exemption	Sales and Use	2.2
Prescription Medication	Exemption	Sales and Use	1.9
Property and Other Taxes	Deduction	Personal Income	1.7
Research and Development Costs	Credit	Corporation Income	1.6
Benefits Under Cafeteria Plans	Exclusion	Personal Income	1.5
Dependent Exemption Credit <sup>1</sup>	Credit	Personal Income	1.3
Employee Business Expenses	Deduction	Personal Income	1.2
Investment Income on Insurance	Exclusion	Personal Income	1.2
Interest on Municipal Debt	Exclusion	Personal Income	1.2
Special Filing Status	Filing Status	Personal Income	1.1
Sales of Certain Farm Products	Exemption	Sales and Use	1.0

<sup>1</sup> In excess of the amount of the personal exemption credit.

Source: Franchise Tax Board and Department of Finance

## ISSUES TO CONSIDER

### Enacting and Maintaining Tax Expenditures

Unlike direct spending, TEPs do not come through the legislative budget process, and thus, are not regularly evaluated as to their appropriateness or effectiveness. This is in stark contrast to budget proposals, which are reviewed through the budget process in both houses of the Legislature on an annual basis. Some TEPs are of limited duration ('sunsetting') or limited to the aggregate amount ('capped'). For example, the film tax credit has a sunset and a cap that limit program funding to \$330 million annually for five years. However, other 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. While TEPs may be enacted by simple majority vote, altering or eliminating them requires a two-thirds super majority.

As a result of this process and limited effective oversight, many TEPs are on the equivalent of 'automatic pilot.' One example is the R&D expenses tax credit. Although

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among TEPs and indirect taxpayer behavioral responses as a policy change works its way through the economy.

many economists and tax analysts recognize the value of some form and level of R&D credit, there has been only limited methodical evaluation of the effectiveness or efficiency of California's program 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 to result in a combined corporation tax and personal income tax revenue impact of approximately \$1.6 billion (and growing to an estimated \$1.8 billion by 2017-18).

### **Evaluating Tax Expenditures**

For many TEPs that are designed to provide tax relief, the evaluation of the program is relatively straightforward. An evaluation would typically calculate the amount of tax relief provided by various income levels. For the food exemption, this would entail using federal data regarding consumption patterns to provide exemption benefit estimates across the income spectrum. Similarly, California tax data sampling can be used to provide estimated benefits for the personal exemption credit across income groups.

For TEPs designed to incentivize certain behaviors, the evaluation process tends to be much more involved, costly, challenging and somewhat speculative. For these TEPs, the intent of particular incentive measures varies considerably, data may be not easily obtained or simply be unavailable, and the estimation process may only provide a rough approximation of the actual impact of the measure. In addition, these estimates typically involve numerous economic assumptions over which there may not be a complete consensus.

As noted, most TEP evaluations limit themselves to 'static', as opposed to 'dynamic', estimates. The former approach generally considers only the first-order effects of the tax measure. A 'dynamic' approach would expand the evaluation to consider impacts as the change in policy worked its way through the economic system resulting in total macroeconomic impacts. While the 'dynamic' approach is arguably more complete, it potentially suffers from significant specification issues, as well as being extremely sensitive to underlying economic assumptions.

Despite the difficulties involved in evaluation, these TEP studies have real merit and are important for the Legislature to consider in its deliberations. In addition, such applied evaluations—frequently conducted by academic researchers and professional research organizations—can be combined with the state's own evaluation efforts to provide a robust basis for the evaluation program for TEPs. Existing reporting by the four agencies noted above provides annual monitoring of the budgetary impacts of TEPs, but there is no established evaluation process regarding TEPs effectiveness. In contrast, several states have such programs in place, including:

- **Florida.** Requires that economic development incentives be evaluated every three years by two different state agencies.
- **Indiana.** Establishes that all tax incentives be evaluated every five years through an independent legislative commission.

- **Washington.** Provides that all tax expenditures expire ten years after enactment, unless extended by lawmakers after an evaluation by audit staff.
- **Mississippi.** Mandates that a research center led by the state economists provide an evaluation of economic development TEPs every four years.

### Monitoring Budgetary Impacts

In recent years, the Legislature has taken a much more cautious approach to enacting new TEPs than it has in the past. While these efforts do not address TEPs that have previously been enacted and are responsible for the overwhelming proportion of the budgetary impact on the state, the approach does hold the prospect of reducing the overall impact on the General Fund from what it might have been otherwise. There are several steps that the Legislature could consider in its approach to special tax provisions, as outlined below.

- **Sunset and Cap.** One approach is that taken with the state’s film credit program. While there is generally a critical view by economists and tax analysts regarding the efficiency and appropriateness of film tax credits, the fact that California’s program is capped and time-limited will avoid the long term fiscal erosion associated with other tax programs. It should also prevent continued growth in a credit that may or may not be an effective use of state resources.
- **Combine Caps.** A more involved version of the cap was incorporated in California’s economic development tax incentives—the sales tax exemption for equipment, the hiring tax credit and the California Competes tax credit. This version requires DOF to estimate the cost of the programs and if the combined revenue impact is expected to exceed \$750 million, the dollars available for California Competes are reduced. By combining programs under one cap, the three programs costs will not exceed more than budgeted, and the priority of the sales tax exemption is preserved.
- **Evaluate TEPs.** The state might also require the compilation and analysis of additional data for each TEP enacted. Additional data could be required to be gathered, submitted and analyzed as an integral part of the implementation of the TEP as is done in other states. This effort could be directed towards data that would facilitate evaluating the effectiveness of the particular tax program and might also stipulate that prospective beneficiaries submit data and other information in order to be eligible for the incentive.
- **Implement Triggers.** Finally, the use of ‘triggers’—which usually involves external measures to switch on or off a particular tax program—could be integrated into the tax program and provide an objective external control. One recent example of this is the state’s former manufacturers’ investment credit, which triggered-off based on changes in the state employment in specified industrial sectors.

## General Obligation Bonds

### BACKGROUND

The state uses general obligation (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. GO 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 considered in the annual budget bill process except as an informational item. Based on December 2015 data, the state has \$75.3 billion in outstanding GO bond debt (including self-liquidating bonds). Another \$28.2 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 displays the state’s authorized, but unissued, reservoir of bonds.

**General Obligation Bonds Authorized and Not Issued**  
(Dollars in Million)

Date and Authorizing Bond Program	Unissued Amount
Prop 1A of 2008: High-Speed Rail	\$8,923
Prop 1 of 2014: Water Quality, Supply, and Infrastructure	7,520
Prop 1B of 2006: Transportation	2,889
Prop 84 of 2006: Safe Drinking Water	2,485
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,719
Prop 71 of 2004: Stem Cell Research	1,124
Prop 46 of 2002 & Prop 1C of 2006: Housing	1,039
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	635
Prop 41 of 2014 & Prop 16 of 2000: Veterans Housing	599
All other	1,243
<b>Total</b>	<b>\$28,176</b>

<sup>1</sup> Non-self liquidating.

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 reflecting how fast projects will expend funds and uncertainty about the timing of the next bond sale. Based on November 2015 data, there is about \$1.4 billion in bond cash on-hand, distributed across various bond programs. This compares to about \$4.0 billion in unspent bond proceeds at this same time last year. Reducing the level of unused bond proceeds is generally considered to constitute wise bond-proceeds management, as it minimizes the amount of idle cash upon which interest must continue to be paid.

**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 source. The Economic Recovery Bonds (ERBs), which were self-financed, received a quarter-cent of the sales tax as a component of the ‘triple flip’ enacted as part of the 2004 budget package. The ERBs have now been paid off, and sales tax resources dedicated to General Fund bond repayment are now flowing to local governments and the property tax backfill shifted back to K-14 education.

The Governor’s budget includes \$4.9 billion in General Fund costs for GO bond debt service and related costs. In addition, about \$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 2016-17, allowing for a reduction in General Fund expenses. The Governor’s proposed budget includes about \$126 billion in General Fund available for debt service (including carry-over balances but excluding amounts to be transferred to the BSA). The net General Fun debt service for GO bonds as a percentage of General Fund resources is approximately four percent.

**Governor’s Budget for General Obligation Bond Debt  
(Dollars in Millions)**

Category	2014-15 Actual Cost	2015-16 Estimated Cost	2016-17 Forecasted Cost
General Fund Cost <sup>1</sup>	\$4,737	\$4,870	\$4,913
Other Funds Cost	941	1,133	1,244
Federal Subsidy (Build America Bonds)	326	326	326
<b>Total Debt Service</b>	<b>\$6,004</b>	<b>\$6,329</b>	<b>\$6,483</b>

<sup>1</sup> Includes variable rate bond and commercial paper expenses.

Debt service is expected to creep up in the budget year due to recent past bond sales and anticipated issuances. The State Treasurer’s Office (STO) plan includes an assumption that \$3.3 billion in General Obligation bonds will be sold (or have been sold) in 2015-16, and that \$4.0 billion will be sold in 2016-17. In addition, the STO assumes that \$6.6 billion in bonds will be retired over the same period. In recent years, the state’s GO Bond debt service cost per borrowed dollar has generally declined. This has occurred not only because of the general decline in interest rates, but also the state’s improved credit rating. In 2010, the spread between California’s 30-year borrowing costs was 150 basis points (1.5 percent) higher than term-comparable AAA rated paper; while the current spread is closer to 25 basis points. The STO has taken advantage of this dynamic and maintained an active refinancing program.

**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 typically 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 gross debt service requirements for infrastructure for bonds already sold will remain around 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. The Legislature can increase or limit bond funding through the budget process as overall expenditures are prioritized.

Despite the interest costs associated with debt, the decision to issue bonds comes with numerous advantages, as outlined above. In addition to these benefits, the current interest rate environment, which continues to display very low long term rates, presents unique advantages for the issuance of long-term debt for the state. For AA rated twenty year paper, the average yield continues to be under three percent.<sup>1</sup> These low rates have persisted, despite the relatively strong US economy which would ordinarily place upward pressure on interest rates.

The Administration proposes maintaining its current market level of bond issuance and to pay for substantial capital improvement through cash outlays. While this is not an unreasonable use of cash, an alternative process to consider would involve borrowing during the current, low-interest rate environment and retaining the cash for use during a future period when higher interest rates prevail.

**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

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<sup>1</sup> California's current long-term General Obligation bond ratings from the three major services are: Moody's-Aa3; Standard & Poor's-AA-; Fitch-A+.

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, thus reducing the need to carry large bond cash balances. As part of this effort, the Administration 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 \$1.4 billion by the end of December 2015. 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, deferred various payments to schools and other entities, and taken certain other measures 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 was formerly referred to as the “wall of debt”. The DOF no longer formally calculates the “wall of debt”; however, the amount formerly included in this calculation is expected to be reduced to a total of about \$9.0 billion by the inception of 2016-17.

Some obligations included in this list 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 depending upon the budget condition, 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 these budgetary obligations, the state has accumulated liabilities for retirement costs for state employees, teachers, judges, and University of California employees. These latter liabilities will total an estimated \$219.7 billion at the start of 2016-17. Some of these unfunded liabilities are being addressed with routine annual payments over time.

Proposition 2, which revises the state’s Budget Stabilization Account (BSA), was approved by the voters in November 2014. The measure changes the way the state pays down debts and liabilities, as well as how it sequesters money in reserves. According to the Legislative Analyst’s Office (LAO), Proposition 2 could result in roughly \$15 to \$20 billion being used to pay down certain state debts through the duration of the measure’s debt payoff requirement. Choices about how calculations are made under Proposition 2 determine the amount of funds that are split evenly between the BSA and debt pay-down. 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 \$3.1 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 \$1.6 billion on paying down \$955 million in special fund loans, \$257 million in prior-year Proposition 98 costs known as “settle-up” and \$173 million in transportation loans. In addition, the Governor’s multi-year budget plan proposes to fully repay special fund loans and transportation loans by the end of 2019-20. Due to the dynamic nature of budgeting and changing fiscal circumstances, the pay-off schedule always changes somewhat from year to year. Detail on the Governor’s current plan is displayed in the table below.

**Proposal for Debt and Liabilities Payments  
(Dollars in Millions)**

<b>Category</b>	<b>Amount Beginning of 2016-17</b>	<b>Payment in 2016-17</b>
<b>Budgetary Borrowing</b>		
Special Fund Loans and Interest <sup>1</sup>	\$1,806	\$955
Proposition 98 Settle-Up Underfunding <sup>1</sup>	1,232	257
Transportation Loans (Pre-Proposition 42) <sup>1</sup>	879	173
<b>Subtotal Debt</b>	<b>3,917</b>	<b>1,385</b>
<b>Retirement Liabilities</b>		
State Retiree Health	71,773	-
State Employee Pensions	43,291	-
Teacher Pensions	72,718	-
Judges' Pensions	3,358	-
CalPERS Deferred Payment	570	
UC Employee Pensions <sup>1,2</sup>	10,786	171
UC Retiree Health <sup>2</sup>	17,270	-
<b>Subtotal Liabilities</b>	<b>219,766</b>	<b>-</b>
<b>Grand Total</b>	<b>\$223,683</b>	<b>\$1,556</b>

<sup>1</sup> Payment under Proposition 2.

<sup>2</sup> Not a state government liability.

The special fund loans that would be repaid under the Governor’s proposal are shown in the figure on the following page.

**Governor's Proposal for Repayment of Special Fund Loans  
(Dollars in Millions)**

<b>Fund Name</b>	<b>Amount</b>
Unemployment Compensation Disability Fund	\$308.2
Greenhouse Gas Reduction Fund	100.0
Off Highway Vehicle Trust Fund	112.0
School Land Bank Fund	59.0
Harbors and Watercraft Revolving Fund	51.0
Hospital Building Fund	50.0
Oil Spill Response Trust Fund	40.0
Housing Rehabilitation Loan Fund	35.4
Accountancy Fund	21.0
State Corporations Fund	18.5
Tax Credit Allocation Fee Account	13.0
State Board of Barbering and Cosmetology Fund	11.0
Vehicle Inspection Repair Fund	10.0
Enhanced Fleet Modernization Subaccount	10.0
Psychology Fund	6.3
Behavioral Science Fund	6.3
Contingent Fund of the Medical Board of California	6.0
Firearms Safety and Enforcement Special Fund	4.9
Acupuncture Fund	4.0
Professional Engineers' and Land Surveyors' Fund	3.2
Private Postsecondary Education Administration Fund	3.0
Real Estate Appraisers Regulation Fund	3.0
Registry of Charitable Trust	2.7
Environmental Water Fund	2.4
Antiterrorism Fund	2.0
Drinking Water Operator Certification Special Account	1.6
Private Investigator Fund	1.5
Physician Assistant Fund	1.5
Osteopathic Medical Board of California Contingent Fund	1.4
California Water Fund	1.1
State Optometry Fund—Professions and Vocations	1.0
<b>Total</b>	<b>\$891.0</b>

**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, prior years highlighted the \$71.8 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. While the Administration could have used a portion of the Proposition 2 funds to pay down some of the retiree health care unfunded liability, the Governor actually proposes not to begin working this debt down until 2017-18, with a modest initial payment of \$50.0 million. 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 fiscally necessary and some of the loans could be repaid to help meet the desired program objectives; however, some repayments are unnecessary to make at this time, as the programs have been operating for many years without the funds. While working down the smaller amounts of special loan repayments cleans-up the state's balance sheet, augmenting resources devoted to pension liabilities sooner can have a substantial impact on future state liabilities.

## 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's cash position did not require the issuance of a RAN.

Total monthly borrowable internal resources from some 700 plus funds are typically in the range of \$20 billion, although these amounts have increased during the recovery period. The state also established a cash flow tool in the form of the Voluntary Investment Program (VIP) in 2012. This measure provides 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. The fiscal impact of these deferrals varies from entity to entity, depending upon their own cash positions. In past 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 prior year 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. In the current year, the state was able to shift education payments back to the appropriate year, as additional revenues allowed for activating a trigger mechanism that eliminated all K-14 deferrals.

### GOVERNOR'S PROPOSAL

The Governor's budget does not anticipate engaging in external borrowing (RAN) in 2016-17 and assumes that internal borrowing will be adequate to cover the low points in the state's cash position. This is the second year in a row that the state will avoid costs of external borrowing and reflects the state's improved cash position and, if projections hold, would be only the third 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 September and March, requiring a draw on internal cash resources of cash resources of \$7.9 billion and \$4.6 billion, respectively. Total unused internal cash resources are substantial over the budget year,

and range from a low of \$19.0 billion in March 2017 to a high of \$33.9 billion in June 2017.

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 \$15 million for interest costs associated with internal borrowing. As mentioned earlier, the Administration has not proposed a RAN, and the budget does not include any costs associated with external borrowing for cash flow purposes. There is also no anticipated need for the VIP or the SAIF in the Governor's budget. The Administration has not incorporated any new deferrals as part of the budget plan; however, the Governor's budget assumes smoothing of payments to UC and CSU in a manner similar to the past years. The cash management strategy for higher education is funding one-twelfth of the total appropriation in each month.

### 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 current and coming year is a positive development. The Administration's proposal appears to be a suitable approach to cash flow management and the lack of external borrowing reflects the state's continued overall fiscal health.

# SUBCOMMITTEE No. 5

## CORRECTIONS, PUBLIC SAFETY, AND THE JUDICIARY

### **Corrections and Public Safety**

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# California Department of Corrections and Rehabilitation: Blueprint 2.0

## BACKGROUND

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 20, 2016, CDCR housed 127,323 adult inmates in the state's prison system, a 5,385 person decrease over the January 21, 2015 population. Most of these inmates are housed in the state's 35 prisons and 43 conservation camps. Approximately 5,100 inmates are housed in out-of-state contracted prisons and 5,600 are housed in in-state contracted facilities. CDCR also supervises and treats about 44,000 adult parolees.

**Historical context.** For years, California's prison system has faced costly and seemingly endless challenges. Decades-old class-action lawsuits challenge the adequacy of critical parts of its operations, including its health care system, parole-revocation process, and ability to accommodate inmates with disabilities. In one case, a federal court seized control over the prison medical care system and appointed a Receiver to manage its operations. The Receiver remains in place today.

Further, a growing inmate population has exacerbated the prison system's challenges. In a spring 2011 ruling, the United States Supreme Court ordered California to reduce its prison population by tens of thousands of inmates by June 2013. During this time, CDCR's budget continued to rapidly grow amid the state's budget crisis.

It is within this context that the Legislature and the Governor enacted realignment, shifting responsibility for certain lower level, non-violent, felony offenders from the state to the counties. In addition to realignment, in 2012, the Administration proposed a comprehensive, long-term plan, *The Future of California Corrections: A blueprint to save billions of dollars, end federal court oversight and improve the prison system* (blueprint), to improve the effectiveness of the state's prison system. The Legislature adopted the plan--based on the understanding that over time, it would significantly reduce CDCR's budget and the prison population--and approved the necessary funding and statutory changes.

**Blueprint.** In April 2012, CDCR released its blueprint detailing the Administration's plan to reorganize various aspects of CDCR operations, facilities, and budgets in response to the effects of the 2011 realignment of adult offenders, as well as to meet federal court requirements. The blueprint was intended to build upon realignment, create a comprehensive plan for CDCR to significantly reduce the state's investment in prisons, satisfy the Supreme Court's ruling to reduce overcrowding in the prisons, and get the department out from under federal court oversight. In the blueprint's introduction, the Administration stated:

*Given the ongoing budget problems facing California it has become increasingly important to reexamine the mission and priorities of the corrections system. With dedicated funding directed to county governments to manage lower level offenders, realignment allows the state to focus on managing the most serious and violent offenders. And it allows counties to focus on community-based programs that better promote rehabilitation. Not only is this good corrections policy, but it also allows the state to achieve significant budgetary savings from a department whose share of General Fund expenditures had grown from 3 to 11 percent over the last 30 years.*

*As a result of the declining populations, the state will be able to save nearly half a billion dollars by closing the California Rehabilitation Center—one of its oldest, most costly, and inefficient prisons to operate—and ending contracts for out-of-state prison facilities. The savings contemplated in this plan will be attained by safely reclassifying inmates, housing inmates in facilities that are commensurate with their custody level, and working to reduce recidivism. Capitalizing on the opportunities created by realignment will create a safer, more effective correctional system, and allow the state to regain control of its prison system by satisfying federal court requirements.*

*Combining the actual budget savings with the avoided expenditures that would have been required without realignment, over a ten year span the state will have saved and avoided over \$30 billion in General Fund costs that may now be used to help balance the state budget or for other critical areas such as education and health care.*

The Budget Act of 2012 and related trailer bills approved both funding augmentations and reductions associated with the blueprint and adopted necessary statutory changes. In addition, the Legislature made several changes to the blueprint to increase transparency and accountability, including creating a separate budget item for CDCR's rehabilitative programs and giving the Office of the Inspector General (OIG) oversight over the implementation of certain aspects of the blueprint.

In addition to an expectation of General Fund savings, the Legislature, in approving the blueprint and public safety realignment one year earlier, expressed concerns during budget hearings that the Administration had not provided a comprehensive plan designed to reduce the number of people either coming to prison for the first time or returning to prison. The Legislature and the federal court both signaled clearly to the Administration that the state could not grow its way out of this problem by simply increasing prison capacity. Furthermore, through budget hearings and discussions with the Administration the Legislature was reassured that if it approved the construction of infill facilities and allowed for in-state contracted prisons, once the new facilities were open, the state would not have added any new capacity, CDCR would close California Rehabilitation Center (CRC), and out-of-state inmates would return to in-state prisons.

**SB 105 (Steinberg and Huff), Chapter 310, Statutes of 2013.** Subsequent to the passage of the 2012 Budget Act, in September 2013, the Legislature passed, and the Governor signed, SB 105 to address the federal three-judge panel order, which required the state to reduce the prison population to no more than 137.5 percent of design capacity by December 31, 2013. SB 105 provided the CDCR with an additional \$315 million in General Fund support in 2013-14 and

authorized the department to enter into contracts to secure a sufficient amount of inmate housing to meet the court order and avoid the early release of inmates, which might otherwise be necessary for compliance. The measure included sunset provisions allowing for contracted facilities until January 1, 2017. The measure also required that, should the federal court modify its order capping the prison population, a share of the \$315 million appropriation in Chapter 310 would be deposited into a newly-established Recidivism Reduction Fund.

Four years later, despite (1) the commitment made in the original blueprint, (2) an understanding between the Legislature and the Administration based on the original blueprint proposal and the discussions and hearings surrounding the approval of SB 105 that the approval of funding for more contract prison beds and the construction of three infill projects would not result in additional prison beds in the long-term, and (3) the state assumption in the blueprint that adopting the proposals through the 2012-13 budget would result in \$3 billion in savings per year, the 2016-17 budget proposes to spend over \$1 billion more than the state spent in 2011-12 (growing to over \$2.3 billion if the revenue shifted to counties for realigned felons is included). In addition, with the activation of new infill facilities this spring, the state will maintain 5,211 more beds than at the time of the blueprint.

### **CDCR's Original Blueprint and the Updated Blueprint**

On January 20, 2016, the Administration released *An Update to the Future of California Corrections* to document why certain commitments made in the original blueprint did not materialize, and to establish new long-term priorities for CDCR. Below are key provisions that differ between the original and revised blueprint:

**Original Blueprint: Higher Prison Population Estimates Than Projected in 2012.** The original blueprint assumed that the prison population would continue on a downward trend. The blueprint projected a total population of 133,746 inmates as of June 2012. By the end of 2014-15 that population was projected to be 123,149. Of the 123,149 inmates, 117,565 were projected to be housed in adult institutions, with the remainder housed in fire camps or contract facilities, this would result in the state being at 142.3 percent of prison capacity.

- **Updated Blueprint.** One of the most significant revisions to the original blueprint is the population estimate. The updated plan notes that the original blueprint significantly underestimated the inmate population. The original blueprint assumed an inmate population of approximately 124,000 as of June 30, 2017. The revised estimates suggest that the population will bottom out at 128,000 in June 2016, and will begin to rise, reaching 131,000 inmates by June 30, 2020. The report notes that it is this increased population that drives their request to maintain a higher capacity than assumed in the original blueprint as discussed in more detail below.

**Original Blueprint: \$3 billion in Savings Did Not Materialize.** The Administration asserted that the blueprint would reduce state spending on adult prison and parole operations by \$1 billion in 2012-13, as a result of 2011 realignment. The plan estimated that these savings would grow to over \$1.5 billion by 2015-16, and assumed an ongoing annual savings of over \$3 billion. Over ten years, the blueprint projected a state General Fund savings of approximately \$30 billion.

- **Updated Blueprint.** Rather than achieving the ongoing annual savings of over \$3 billion per year over CDCR's pre-realignment budget envisioned in the original blueprint, the CDCR budget has consistently grown since the time of its adoption. The proposed 2016-17 budget for CDCR is approximately \$10.3 billion. In addition, the estimated realignment revenue for local community corrections (which would otherwise come to the state General Fund) is \$1.3 billion. This totals \$11.6 billion in spending on California's incarcerated felons. Prior to realignment, in 2010-11, the state spent approximately \$9.7 billion on incarcerated felons housed in state institutions and camps.

The revised plan details several areas where costs have risen in excess the assumptions made in the original blueprint. Specifically, increased employee compensation and retirement costs are estimated to consume about \$835 million in 2016-17. In addition, costs for the Correctional Health Care Facility (CHCF) have increased by approximately \$289 million. Along with those increases, the CDCR budget now contains \$430 million in lease-revenue bond payments per year (an increase of \$170 million over the 2012 Budget Act) related to the cost of constructing CHCF, Health Care Facility Improvement Projects, infill capacity, and construction grants provided for local jails. Finally, the report notes that 11,396 inmates remain in leased or contracted facilities that cost the state \$385 million per year.

**Original Blueprint: No Elimination of Contracted Prison Beds.** The department began sending inmates out-of-state when overcrowding was at its worst in 2007. At the time of the blueprint, there were more than 9,500 inmates housed outside of California. The blueprint projected that by 2014-15 there would be 1,864 inmates remaining in out-of-state contract beds and committed to ending all out-of-state contracts by 2015-16. Returning out-of-state inmates to in-state facilities was expected to save the state \$318 million annually. In addition, the blueprint assumed that as of June 30, 2016, there would only be 1,825 inmates in in-state contract beds.

- **Updated Blueprint.** The Administration proposes maintaining 4,900 inmates in out-of-state facilities in Arizona and Mississippi for the foreseeable future. As noted above, the Administration thinks that the higher than originally projected inmate population will require them to continue to need out-of-state capacity. However, the Administration also requires legislative approval to continue the use of out-of-state beds because the statutory language authorizing contract beds is scheduled to sunset.

In addition to out-of-state contracts, CDCR has increased utilization of in-state contract beds above the levels contained in the original blueprint. As noted above, there were approximately 5,600 inmates in in-state contract beds, including California City, as of January 20, 2016. The budget also contains trailer bill language extending the sunset date for in-state contract facilities and the lease of California City, all of which are due to expire on December 31, 2016. The draft trailer bill language proposes extending the sunset for all contract and lease facilities until December 31, 2020.

**Original Blueprint: Makes Minimal Progress on Rehabilitation.** The blueprint required the department to improve access to rehabilitative programs and place at least 70 percent of the department's target population (approximately 36 percent of the total prison population) in programs consistent with academic and rehabilitative needs. The blueprint further set June 30, 2015, as the completion date for reaching that goal.

Toward that end, the blueprint required the establishment of reentry hubs at certain prisons to provide intensive services to inmates as they get closer to being released. It also required the creation of enhanced programming yards, which are designed to incentivize positive behavior. For parolees, the blueprint increased the use of community-based programs to serve, within their first year of release, approximately 70 percent of parolees who need substance-abuse treatment, employment services, or education.

- **Updated Blueprint.** In the revised blueprint, the Administration notes that it fell short of reaching its target and has only reached 60 percent of the target population. Further, the department continues to count an inmate who shows up for only one day for a program toward meeting the goal of reaching their target. The Office of the Inspector General has consistently recommended that CDCR only count a person as having met the requirement when the person completes a program. Given CDCR's counting method, it is unclear how many people receive rehabilitative programming, either in the larger population or within their much smaller target population. The revised blueprint notes that CDCR is working with the Inspector General to revise their counting methodology and they acknowledge that the new methodology would take the department farther away from the original goal.

**Original Blueprint: Successfully Increased In-State Prison Capacity.** As noted above, the original blueprint required the return of all inmates who were being housed outside of California. In order to accommodate the return of those inmates and the closure of the California Rehabilitation Center (discussed below), the blueprint outlined a plan for increasing in-state prison beds through the modification of existing facilities and the construction of three new infill-projects.

The blueprint called for the construction of additional low-security prison housing at three existing prisons. The proposed projects would have capacity for 3,445 inmates under the 145 percent population cap proposed by the blueprint (design capacity of 2,376 beds) and would include space to permit the operation of inmate programs such as mental health treatment and academic programs. In addition, the blueprint called for the renovation of the DeWitt Nelson Youth Correctional Facility to house adult offenders. The facility would serve as an annex to the California Health Care Facility (CHCF) that was under construction in Stockton. Under the proposed 145 percent population cap, the DeWitt facility would have capacity for 1,643 lower-security inmates (design capacity of 1,133 beds). Finally, the blueprint proposed converting the Valley State Prison for Women into a men's facility and the conversion of treatment facilities at Folsom Women's Facility into dormitory housing.

- **Updated Blueprint.** The department has fully activated the DeWitt Annex at CHCF, with a design capacity of 1,133 beds. In addition, they anticipate the activation of the infill projects

at Mule Creek State Prison and RJ Donovan State Prison later this spring. Those infill projects will add an additional 2,376 beds to the prison system. Combined, these projects approved through the blueprint, increase the state's prison capacity by over 4,807 inmates (under the current population cap of 137.5 percent).

The updated report, however, rather than reducing contract capacity or closing CRC (as discussed below) finds that CDCR has an on-going need for additional capacity. Specifically, the original blueprint assumed that the bed capacity at the end of 2015-16 and ongoing would be approximately 124,438 beds. In the updated plan, the Administration assumes there will be an on-going need for 133,054 beds, which is an increase of 8,616 beds.

**Original Blueprint: Will Not Close the California Rehabilitation Center (CRC) in the Foreseeable Future.** The blueprint assumed that one prison, CRC (Norco), would be closed in 2015-16. This planned closure was due to the fact that CRC is in need of significant maintenance and repair. In addition, the Administration proposed that the savings achieved from closing CRC would offset the costs of operating the new infill beds (mentioned above). This goal was revised by SB 105 which suspended this requirement pending a review by the Department of Finance and CDCR that will determine whether the facility can be closed.

The 2015-16 budget included statutory language requiring the Administration provide an updated comprehensive plan for the state prison system, including a permanent solution for the decaying infrastructure of the California Rehabilitation Center. In addition, state law provides legislative findings and declarations that, given the reduction in the prison population, the Legislature believes that further investment in building additional prisons is unnecessary at this time and that the California Rehabilitation Center can be closed without jeopardizing the court-ordered population cap.

- **Updated Blueprint.** The new blueprint is intended to fulfill the requirement in the 2015-16 budget that the Administration provide the Legislature with an updated comprehensive plan for the prison system. However, in the revised blueprint, the Administration maintains that they are unable to close CRC in the near future, but states that it remains committed to its closure at an unspecified future date. The proposed budget also includes \$6 million in General Fund for critical repairs to the facility. In addition, the report states that the Administration will work with the Federal Healthcare Receiver to determine other physical plant improvements needed to improve health care access at the facility.

**Achieved Standardized Staffing Levels.** Realignment's downsizing left the department with uneven, ratio-driven staffing levels throughout the system. The blueprint proposed adopting a standardized staffing model for each prison based on factors such as the prison's population, physical design, and missions. For the most part, prison staffing levels would remain fixed unless there were significant enough changes in the inmate population to justify opening or closing new housing units. In contrast, historically prison staffing levels were adjusted to reflect changes in the inmate population regardless of the magnitude of those changes.

- Updated Blueprint.** The report notes that the department has fully adopted a standardized staffing model and no longer uses a staffing model based upon the size of the prison population. The 2016-17 budget includes resources for 23,151 correctional officers to provide security at all state-run institutions and camps. This is an increase of 1,099 over the number of correctional officer positions at the time of the original blueprint. A portion of this increase is due to the activation of California City, the California Healthcare Correctional Facility (CHCF) and the infill projects at RJ Donovan and Mule Creek. However, it is also important to note that in April 2012, when the blueprint was released, the prison population was close to 138,000 inmates. At its peak population of approximately 170,000 inmates, CDCR was budgeted for approximately 24,332 correctional officers.

**California Department of Corrections and Rehabilitation:  
Summary of Institutions, Inmates and Correctional Officers**

Year <sup>1</sup>	Number of Institutions	Number of Conservation/ Fire Camps	Number of Inmates <sup>2</sup>	Number of Correctional Officers	Inmate to Correctional Officer Ratio
2006-2007	33	42	173,000	24,332	7.1:1
2012-2013	33	42	138,000	22,052	6.2:1
2016-2017	35	43	129,000	23,151	5.6:1

<sup>1</sup> 2006-07 and 2012-13 population figures as of June 30. 2016-17 represents the average population projected in the Governor’s January budget.

<sup>2</sup> Totals rounded to the nearest 1,000.

**GOVERNOR’S PROPOSAL**

**California Department of Corrections and Rehabilitation (CDCR).** The budget proposes total funding of \$10.5 billion (\$10.3 billion General Fund and \$200 million other funds) in 2016-17. This represents a \$470 million increase over the 2015 Budget Act and a \$1.1 billion increase over 2012 Budget Act, when the original blueprint was approved. Specifically related to the original blueprint, the budget requests:

- Legislative authority to continue the use of in-state and out-of-state contract beds beyond the December 31, 2016 sunset date established by SB 105 (Steinberg) Chapter 310, Statutes of 2013.
- Continued operation of the California Rehabilitation Center, which was slated to be closed in *The Future of California Corrections Blueprint* and whose closure was assumed under the 2012 Budget Act.
- \$6 million General Fund to address critical repairs and deferred maintenance projects at the facility in Norco, California.

## ISSUES TO CONSIDER

**In depth Review of Blueprint.** The *Updated Future of California Corrections* includes a fairly comprehensive set of long-term investments and planning for CDCR. This summary provides a discussion of a few of the larger components of the plan. However, a broader review and examination of the plan by the Legislature through both the budget and policy process is warranted. For example, the plan touches on the department's need to develop succession planning for future leadership. In addition, the revised plan briefly discusses the need to increase security in the prisons through video monitoring, especially at the higher security prisons, such as High Desert State Prison. Finally, the report discusses the need to reevaluate the use of sensitive needs yards and perhaps expand the use of enhanced programming facilities. All of these investments merit careful and thoughtful consideration by the Legislature.

**The Prison Population Reduction and General Fund Costs Savings Envisioned in the Blueprint Have Not Materialized.** The long-term plan for the state's corrections system was developed in the context of restructuring the prison system in response to realignment and the federal court's ongoing requirement that the state reduce its prison population to 137.5 percent of capacity. However, instead of reducing the state's investment in the correction's system, as promised by the blueprint, that investment continues to grow at a significant rate. Given that the Administration is asking the Legislature to disregard their original commitment to returning prisoners from out-of-state prisons and close CRC, the Legislature may wish to use this opportunity to reassess other agreements that were made in the context of adopting the blueprint-- including standardized staffing-- and consider alternative, sustainable, long-term solutions that will both reduce the prison population and limit General Fund costs associated with incarcerating large numbers of Californians for significant periods of time.

**Alternative Custody Placements.** The Legislature may wish to find ways of supporting and expanding the initiatives outlined in the "Future Vision" portion of the new plan, which includes system changes that have long been priorities of the Legislature. For example, the Legislature may wish to invest any capacity expansion in reentry programs in the community for both men and women. The budget includes \$32.1 million General Fund to continue and expand the male community reentry program. The state currently has space to house 220 men in community facilities during the last few months of their sentence, and budget proposes expanding that capacity to 680 community reentry beds.

**Increase Evidence-Based Programming for Long-Term Offenders.** The plan and budget include efforts to increase rehabilitation programming and services for long-term offenders who were previously serving life sentences but are now able to be released on parole due to recent statutory changes. The budget includes \$10 million in funding to increase rehabilitation treatment and services specifically for this long-term population. The Legislature may consider additional funding to provide evidence-based, restorative justice programming opportunities for this population in their last 12- to 24-months of incarceration.

In the last two years, the Legislature has included funding in the budget for innovative programming grants. This \$5.5 million in Recidivism Reduction Fund money has allowed

volunteer groups which have demonstrated success in providing programs focused on offender responsibility and restorative justice principles to receive funding to expand their programs to underserved prisons. While this grant program has allowed for an increase in volunteer programming at certain institutions, the Legislature may wish to consider committing on-going funding to non-profit organizations which have successfully provided evidence-based restorative justice programming to life-term or long-term inmates. As these programs are shown to reduce recidivism and reduce institutional violence, an investment that incorporated these programs into the reentry programming provided to long-term inmates, would likely reduce recidivism and reduce the prison population.

## Programs for Victims of Crime

### BACKGROUND

According to Legislative Analyst's Office (LAO), over 250,000 violent crimes occur annually in California. Many of the victims of these crimes require assistance as they recover and participate in the justice system. The state funds services to these victims through 47 separate programs, administered by different entities, including: the Victim Compensation and Government Claims Board (VCGCB), the Governor's Office of Emergency Services (OES), the Department of Justice (DOJ), and the California Department of Corrections and Rehabilitation (CDCR).

#### Victim Services

OES is the Governor's lead response agency during disasters and emergencies. In 2004-05, when the Office of Criminal Justice Planning (OCJP) was eliminated, OES was assigned responsibility for most of the state's victim grant programs, despite, according to the LAO, OES not having expertise in these program areas. The OES largely serves as a "pass-through" entity and provides state and federal funding to the majority of the state's victim services grant programs.

**Funding allocation process.** In 2014-15, OES provided over \$105.8 million (\$21.5 million General Fund, \$65.7 federal funds, and \$18.7 special funds) to various victim programs.<sup>1</sup> According to OES, allocation amounts are based on "historical funding levels and historical reversion rates to assist in determining funding ranges for specified programs. Individual project allocations are [based on] service area population, population and crime statistics, as well as recommendations of advisory groups." If funds for victims services are unused at the end of the grant period, funds revert back to the state, or federal government for federal awards. It is unclear the amount of state or federal reversion that occurs.

**Monitoring performance.** According to OES, it evaluates outputs, rather than outcomes. The department defines "outcomes" as qualitative measures that indicate if an activity has the intended impact to improve a victim's safety or emotional wellbeing; whereas "output" is a quantitative measure that indicates the number of services provided for all sub-recipients. OES conducts programmatic site visits at least once every three years, as well as state and federal financial and compliance reviews. The OES also indicates it conducts audits "when deemed necessary," but no additional specificity was provided as to what circumstances would trigger an audit.

**Funding requirements.** Federal and state requirements often govern the use of funding for victim grant programs. However, these requirements are typically broad and provide the state a significant degree of flexibility in determining the number and type of victim programs the state administers. For example, federal funding sources specify minimum amounts to be spent on

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<sup>1</sup> Governor's Office of Emergency Services Grant Management, Criminal Justice and Victim Services Division, *Joint Legislative Budget Committee Report* (January 2015), <http://www.caloes.ca.gov/GrantsManagementSite/Documents/2015%20JLBC%20Report.pdf>

various types of programs, such as requiring that a minimum of 30 percent of federal Violence Against Women Act (VAWA) funds be spent on direct services to victims. However, federal funds conditions do not require the state to fund specific programs or a number of programs. For programs that receive state funds, OES has significant flexibility to determine allocation amounts because funding for these programs is generally appropriated in aggregate in the annual departmental budget, without allocated amounts for each program. Along with the discretion to determine funding levels for programs, OES also can establish new programs, based on the recommendations of its advisory task forces.

**Victim-Related Task Forces.** The OES administers five victim-related task forces, which collect and disseminate information on victim needs and best practices for programs serving victims. These task forces can recommend the creation of new grant programs, or changes to existing programs, as well as recommend how to allocate funding associated with its various victim programs. The five task forces are:

- Domestic Violence Advisory Council.
- State Advisory Committee on Sexual Assault.
- Children’s Justice Act Task Force.
- Child Abduction Task Force.
- Violence Against Women Act Implementation Committee.

**Stakeholders.** Representation on each task force is primarily based on statutory or funding requirements. According to OES, if representation is not dictated, OES consults with current stakeholders to select who will represent victim groups previously prioritized by OES. The stakeholder selection and identification process begins with a formal solicitation for members, applicant scoring, and selection based on highest combined score. The OES Director makes the final approval in the selection process.

**Victim Witness Assistance Program.** The OES administers the Victim Witness Assistance Program, which provides grants to 58 counties and the City of Los Angeles for victim witness assistance centers. These centers serve approximately 150,000 victims each year, and primarily focus on assisting victims through the justice system and accessing other victim programs through the help of a victim advocate. For example, advocates at the centers accompany victims to court and assist them in applying for compensation from the California Victim Compensation Program (CalVCP). Assistance centers are located statewide, with 51 victim witness assistance centers based in district attorney’s offices; three in county probation departments; three in community-based organizations; one in a county sheriff’s department; and one in the Los Angeles City Attorney’s Office. In 2013-14 and 2014-15, approximately \$10.8 million was

provided to the program. For 2013-14, around 55,000 crisis intervention services were provided to victims of crime, and 144,600 new victims of crime were served.<sup>2</sup>

**Various Other Victim Grant Programs.** The OES administers 39 other grant programs that fund community-based organizations or local agencies that provide services to victims. For example, OES provides grants to rape crisis centers that provide counseling services, self-defense training, and staff who can accompany victims to hospitals or other appointments. Some programs also provide training and other assistance to law enforcement, first-responders, and community based providers in developing effective approaches to assisting victims.

### **Victims Compensation**

The VCGCB is a three-member board comprised of the Secretary of the Government Operations Agency, the State Controller, and a gubernatorial appointee. It administers four victim programs: the CalVCP; trauma recovery center (TRC) grants; the Good Samaritan Program; and the Missing Children Reward Program. The board also administers programs unrelated to victims, including the Government Claims Program, which processes claims for money or damages against the state, and a program that pays claims to wrongfully imprisoned individuals.

The CalVCP, which is responsible for providing compensation to victims of crimes who have been injured, or face the threat of injury, is the largest of VCGCB's programs. The program provides an array of services, including mental health and medical, which a victim's insurance policy may not cover. While a victim is eligible to apply directly to the board, victims are usually referred to the board by a local government.

The Restitution Fund is the primary source of funding for CalVCP, with the majority of this funds revenue stemming from restitution fines, diversion fees, and orders and penalties paid by criminal offenders. For example, when a defendant is found guilty of a crime, as part of the court's ruling, a defendant may be ordered by the court to pay a series of fines and penalties. The collected money is divided among several parties, in accordance with state law. Depending on the situation, the compensation can be provided directly to the victim, or to the provider of services. A portion of the money collected by defendants is deposited directly into the Restitution Fund. Restitution Fund revenues are used as a match to draw down federal funds under federal Victims of Crime Act (VOCA) grant program. The CalVCP receives 60 cents in matching federal VOCA grant funding for each dollar spent to provide victims with services.

**Application to VCGCB.** Individuals can submit an application to VCGCB themselves, or with the assistance of others, such as private attorneys or "victim advocates." Victim advocates are individuals who are specially trained to assist victims and work for locally-run victim witness assistance centers. Because applicants must submit additional information after the initial application, such as a copy of the crime report to verify eligibility for the program, an advocate can help with these often complicated and cumbersome subsequent steps.

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<sup>2</sup> Pursuant to the federal VOCA statistical requirements, the number of victims served and number of services are counted once, so figures may be underrepresented.

<http://www.caloes.ca.gov/GrantsManagementSite/Documents/VW%20done.pdf>

**Trauma Recovery Centers.** The VCGCB also administers a grant program that funds several Trauma Recovery Centers (TRCs). TRCs are centers that directly assist victims in coping with a traumatic event. Types of services provided include: substance use treatment, weekly counseling sessions with a licensed mental health professional for a specified amount of time, and referrals to other community and state services. Currently, VCGCB provides a total of \$2 million annually in grants to four TRCs.

- **San Francisco TRC.** The San Francisco TRC is affiliated with San Francisco General Hospital—a Level I trauma center—and the University of California, San Francisco.<sup>3</sup>
- **Long Beach TRC.** The Long Beach TRC is affiliated with Dignity Health St. Mary Medical Center—a Level II trauma center—and California State University, Long Beach.
- **Los Angeles TRC—Special Service for Groups.** The first Los Angeles TRC to receive state funding is affiliated with a community-based organization, Special Service for Groups, which provides a wide array of services, such as substance use treatment, mental health counseling, and housing assistance.
- **Los Angeles TRC—Downtown Women’s Center.** The second Los Angeles TRC to receive state funding is affiliated with a community-based organization, the Downtown Women’s Center, which provides housing assistance and other supportive services in an effort to end homelessness for women.

Beginning in 2016-17, funding for TRCs will increase as a result of Proposition 47, approved by California voters in November 2014. Proposition 47 reduces the penalties for certain crimes, which will result in state savings, mainly by reducing the number of inmates in state prisons. Under the measure, these savings will be deposited into a special fund with 10 percent of the funds provided to VCGCB for TRCs.

### **Other Programs for Victims**

**CDCR Programs.** While the majority of CDCR’s workload relates to supervising offenders in state prison and on parole, the department also offers certain services to victims. For example, CDCR collects the criminal fines and fees owed by inmates in its facilities. These include restitution orders (payments owed directly to victims) and restitution fines (paid into the Restitution Fund). Typically, when CDCR collects fines and fees owed by offenders, it transfers them out of inmate accounts (accounts maintained for inmates similar to bank accounts). In cases when CDCR is collecting restitution orders for victims, the department transfers the funds from an inmate’s account to VCGCB, which then provides the funds to the victim. In addition, when requested, CDCR will notify victims of certain changes in an inmate’s status, such as if the inmate is eligible for parole or escapes from prison. The CDCR also administers a program that provides a limited amount of funding to assist victims with the cost of travel if they choose to attend a parole hearing.

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<sup>3</sup> A Level I trauma center is a 24-hour research and teaching hospital with the surgical and medical capabilities to handle the most severely injured patients.

**DOJ Programs.** The department provides victim assistance, particularly in cases that are directly prosecuted by DOJ or cases where DOJ is seeking to uphold a conviction on appeal. These services are similar to those provided by victim witness assistance centers and primarily involve assisting the victim through the justice system. In addition, DOJ provides notification services to victims on the status of all cases that are appealed. Given DOJ's expertise with respect to the state's legal system, the department also provides various other services to victims, such as information about the legal process.

**2015-16 Context.** Last year, the Administration proposed shifting the Government Claims Program to the Department of General Services (DGS), while keeping the administration of VCGCB's remaining programs, primarily victims programs, with the board. According to the Administration, the Government Claims Program is better aligned with the mission of DGS to provide services to departments statewide.

In response to and consideration of the proposed reorganization, the Legislature adopted supplemental reporting language (SRL) as part of the 2015 Budget Act, with a report due to the Legislature on January 10, 2016. The SRL directed the Administration (VCGCB and OES) to outline a plan "to reorganize the administration of the state's victim programs to bring all of the state's victim programs under the same administering entity." The SRL required the report to "include a proposed timeline for the new administering agency to develop a comprehensive strategy for victim programs that, at a minimum: (a) evaluates and recommends changes to the number, scope, and priority of state victim programs, and (b) ensures that the state receives all eligible federal funds for victim programs."<sup>4</sup>

**Report to the Legislature.** On January 8, 2016, the Administration submitted a two page report that, aside from providing background on VCGCB and OES and their existing collaborative efforts (e.g., regional trainings, outreach materials), concludes: "[T]he Administration does not believe that a consolidation of victim programs is warranted at this time," noting that "existing programs are working together to ensure that victims are well-served and able to easily access the programs available to them." The report falls short of an adequate response to the directive specified in the adopted SRL.

### **Legislative Analyst's Office Recommendations**

In March 2015, the LAO released *The 2015-16 Budget: Improving State Programs for Crime Victims*.<sup>5</sup> The LAO found significant weaknesses in the state's programs for victims, specifically: (1) programs lack coordination; (2) the state is likely missing opportunities for federal VOCA grants; (3) many programs are small and appear duplicative; (4) narrowly targeted grant programs undermine prioritization; and (5) limiting advocates to victim witness assistance centers limits access to CalVCP. To address these weaknesses, the LAO recommends to:

- **Restructure VCGCB to Better Focus on Victim Programs.** Shift all non-victim programs out of VCGCB to allow the board to focus solely on administering victim programs. In order

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<sup>4</sup> The SRL can be accessed on page 32 of the document, <http://lao.ca.gov/reports/2015/supplemental/2015-16-supplemental-report.pdf>

<sup>5</sup> Available at <http://www.lao.ca.gov/reports/2015/budget/crime-victims/crime-victims-031815.pdf>

to facilitate the restructured responsibilities of VCGCB, change the board's membership to add specific expertise in victim issues.

- **Shift All Major Victim Programs to the Restructured VCGCB.** The restructured board could administer all of the state's major victim programs. As such, shift all of the victim programs administered by OES to VCGCB.
- **Require Restructured Board to Develop a Comprehensive Strategy.** The restructured VCGCB must develop a comprehensive strategy for the state's victim programs. The plan must: (1) assess the appropriate number, scope, and priority of the state's existing victim grant programs; (2) consider ways to ensure that the state receives all eligible federal grant funds; (3) assess the proper role of the state in the CalVCP; and (4) establish a process for periodic evaluations of victim programs.
- **Utilize Proposition 47 Funds to Improve Program Access.** Beginning in 2016–17, the state will begin providing additional grants to trauma recovery centers (TRCs), as required by Proposition 47 (approved by voters in 2014). Ensure these funds are used to improve access to victim services, such as expanding TRCs to additional regions of the state and allowing them to have victim advocates.

## GOVERNOR'S PROPOSAL

**Victim Compensation and Government Claims Board.** The budget proposes \$125 million for VCGCB in 2016-17. Of that amount, \$111 million would be dedicated to victim compensation, \$89 million for direct services at the local level, and \$36 million for state administrative operations. The budget also assumes that \$2.9 million will be available from Proposition 47 for the expansion of Trauma Recovery Centers. Similar to the 2015 proposed budget, the Governor's budget again proposes shifting the Government Claims Program to the Department of General Services, effective July 1, 2016. This would result in a shift of nine positions and approximately \$1.2 million in funding to support the positions.

**Office of Emergency Services.** The Governor's budget proposes \$8.3 million (\$1.3 million General Fund) for state operations costs associated with administering the victim services programs housed at OES, and proposes \$169 million for local assistance for victims services projects.

## ISSUES TO CONSIDER

**Requested Report Fails to Provide a Plan for Reorganization.** The SRL requested the Administration provide a plan to reorganize the administration of victim programs under one entity, as well as a proposed timeline for that new entity to develop a comprehensive strategy for victim programs. However, the report the Administration provided failed to do so; instead it provided information about existing practices and stated that the "Administration does not believe a consolidation is warranted." In part, the Administration attributed the shortcomings of the report to a lack of staff resources. The Legislature may wish to ask the Administration at budget hearings why the report was nonresponsive to the SRL and assess if this may indicate

larger issues about responsiveness to legislative requests or if the state's victim programs are not getting adequate attention in the departments where they are housed.

**Joint Legislative Budget Committee (JLBC) – Federal VOCA Funding.** On December 17, 2015, OES notified the JLBC that it was awarded an additional \$233 million from the federal Victims of Crime Act (VOCA) Formula Grant Program. The letter indicated that OES intended to allocate these funds to eight existing programs and eight new programs under the expenditure authority provided to OES in the 2015 Budget Act. The OES reportedly received notification of this influx of federal funds as early as 2014, yet the Legislature was not notified until December 2015.

When questioned by the JLBC regarding the budget authority that would allow the department to expend almost \$250 million in unanticipated federal funding without legislative approval, the department noted that they have approximately \$1 billion in excess budget authority for the allocation of federal funding. However, this level of funding authority was included in the budget to allow for the receipt of federal funds related to disaster assistance, not for victims-related funding.

In addition, \$78 million of this federal award is directed to establish new programs, an action typically carried-out through the annual budget process in order to allow for more a deliberative and transparent review by the Legislature and public. In light of OES's interpretation of budget authority and its grant award process, the Legislature may wish to consider the following:

- Is it appropriate for the federal budget authority line item to include both disaster and victims-related service funding?
- How can the Legislature statutorily ensure that providers, local governments (cities, counties, etc.), legislative members, community organizations, and advocates are included in a transparent and public stakeholder process?
- How can the Legislature partner with OES to create an effective, qualitative, evidence-based review of programs, as opposed to the current quantitative measures?

**State Emergency Response Responsibilities and Timely Services for Crime Victims.** OES is primarily responsible for the state's readiness, response, and recovery from natural disasters and man-made emergencies. In response to California's wildfires, the department appropriately redirected staff and resources to the emergency. It appears potentially problematic for the state's victim services programs to be administered by the same entity whose mission requires the dispatching of personnel across the state in response to emergencies, possibly disrupting services for and diverting resources from victims of crime. The Legislature should ensure that victim services programs are uninterrupted during state emergencies.

**Creating a Single Entity to Assist Victims of Crimes.** The LAO report and recommendations make clear the lack of meaningful collaboration among the various entities that serve to assist victims of crimes. As such, the Legislature may wish to consider the Governor's proposal to shift government claims to DGS; restructure and broaden membership of the VCGCB to include

representatives of victims services providers, the district attorneys, and trauma recovery centers; and create a single entity within a more appropriate agency. One option may be the Health and Human Services Agency, which is accustomed to leading multiple different departments in providing federal and state benefits to vulnerable or at-risk populations.

**Increased Investment in Trauma Recovery Centers.** Initial estimates from DOF regarding savings related to Proposition 47 suggest that the amount of the savings will be much less than originally anticipated. Rather than the \$10 million to \$20 million range in new funding for TRCs suggested by the LAO, the budget includes less than \$3 million for TRC expansion. Given the value of the trauma recovery model, the Legislature may wish to consider investing additional General Fund to expand TRCs throughout the state.

The concerns of victims have become increasingly recognized over the past decades. Penalties in a determinate sentencing system like California's have been informed greatly by victim advocates. In addition, victim compensation has developed as an important response to crime which is rooted in a growing awareness of the impact of crime on victims. The TRC model focuses on healing the harm that spreads through communities when crimes are committed. This is especially true in relatively poor and marginalized communities where residents have limited access to, and perhaps some discomfort with, medical care and counseling.

Recent research shows that crime can be seen as equivalent to a disease process. Studies demonstrate that public health research methods can predict where and when violence will occur. It is clear that crime, especially violent crime, causes trauma and stress, which often leads to depression and loss of employment, which in turn prevents victims of crime from adequately caring for their families, which can lead to truancy, delinquency, and illness. The study on Adverse Childhood Experiences (ACE) jointly conducted by the Kaiser Foundation and the Centers for Disease control interviewed 17,000 Kaiser patients from 1995-1997. The landmark study showed that childhood abuse, neglect and exposure to trauma is clearly associated with a wide range of physical and mental health problems throughout a person's life. TRC programs can intervene or interrupt cycles of trauma and harm that plague high-crime communities.

## Armed Prohibited Persons System

### BACKGROUND

**Firearms in California.** Under California law, in order to purchase a firearm, an individual must provide a licensed gun dealer with proof of age (21 years for handguns and 18 years for long guns), pass a background check, pay a \$25 fee, and wait for 10 days. In addition, a person purchasing a gun must provide proof that he or she passed the gun safety exam. All firearms must be sold with a locking device. Under certain circumstances, individuals are prohibited from owning or possessing firearms. Generally, a person is prohibited from owning guns if any of the following apply to the individual is on probation or parole or has been:

- Convicted of a felony or of certain misdemeanors.
- Proven to be a danger to himself/herself or others due to a mental illness.
- Been restrained under a protective order or restraining order.
- Convicted of certain crimes as a juvenile and adjudged a ward of the state.

In recent years, there has been a continued and substantial increase in gun purchases, extending through 2013. For example, between calendar year 2012 and calendar year 2013, gun purchases rose by over 15 percent in California. In 2014, the number of sales dipped for the first time since 2007. The table that follows illustrates the annual number of overall purchases of firearms in the state. Despite the dip, gun sales in California have almost tripled over the last decade.

**Firearms in California  
Purchases and Denials**

Year	Hand Guns Purchased	Hand Gun Denials	Long Guns Purchased	Long Gun Denials	Total Guns Purchased	Total Denials
2004	145,335	1,497	169,730	1,828	315,065	3,325
2005	160,990	1,592	183,857	1,878	344,847	3,470
2006	169,629	2,045	205,944	1,689	375,573	3,734
2007	180,190	2,373	190,438	1,926	370,628	4,299
2008	208,312	2,737	216,932	2,201	425,244	4,938
2009	228,368	2,916	255,504	2,221	483,872	5,137
2010	236,086	2,740	262,859	2,286	498,945	5,026
2011	293,429	3,094	307,814	2,764	601,243	5,805
2012	388,006	3,842	429,732	3,682	817,738	7,524
2013	422,030	3,813	538,419	3,680	960,179	7,493
2014	512,174	4,272	418,863	4,297	931,037	8,569

**Firearms Regulation Funding.** Every individual purchasing a firearm in California is required to pay a \$25 assessment. All of the funds go primarily toward supporting firearm safety and regulation within the Department of Justice. The \$25 total is the sum of three separate state fees:

- \$19 background check fee payable to the Dealer Record of Sale Special Account (DROS), which currently funds the APPS program.
- \$5 is payable to the Firearms Safety and Enforcement Special Fund (FS&E).
- \$1 firearm safety device fee is paid to the Firearms Safety Account (FSA).

**Statistics on Gun Violence.** The Centers for Disease Control reports that in 2013, 33,636 people died in firearms-related deaths in the United States. That equates to 10.6 people out of every 100,000. Of those deaths, 11,208 were homicides. According to statistics gathered by the Brady Campaign to Prevent Gun Violence, over 100,000 people a year in the United States are shot. According to the latest United States Department of Justice data, in 2011, about 70 percent of all homicides and eight percent of all nonfatal violent victimizations (rape, sexual assault, robbery and aggravated assault) were committed with a firearm, mainly a handgun. A handgun was used in about seven in ten firearm homicides and about nine in ten nonfatal firearm violent crimes in 2011. In the same year, about 26 percent of robberies and 31 percent of aggravated assaults involved a firearm, such as a handgun, shotgun or rifle.

Beginning in 1999, DOJ Bureau of Firearms began to study some of California's high-profile shootings in an effort to determine if there were remedial measures that could be enacted to curtail instances of gang violence and other similar violent events. The study found that many of the offending individuals were law-abiding citizens when they purchased the firearms, and were subsequently prohibited from gun ownership due to the reasons listed above. At the time of the study, DOJ lacked the capacity to determine whether or not an individual who had legally purchased a firearm, and subsequently became prohibited from such ownership, was still in possession of a firearm. In addition, even if such a determination could have been made, the DOJ lacked the authority to retrieve that weapon from the prohibited person.

In 2001, the Legislature created the Prohibited Armed Persons File to ensure otherwise prohibited persons do not continue to possess firearms (SB 950 (Brulte), Chapter 944, Statutes of 2001). SB 950 provided DOJ with the authority to cross-reference their database of individuals who own handguns with their database listing of prohibited individuals. The 2002 Budget Act included General Fund support of \$1.0 million for DOJ to develop the Armed Prohibited Persons System (APPS). The database was complete in November 2006, with continued funding to support the program provided from the General Fund. Further legislation, SB 819 (Leno) Chapter 743, Statutes of 2011, allowed the department to utilize funds within the Dealers Record of Sale Account (DROS) for firearm enforcement and regulatory activities related to the Armed Prohibited Persons System.

SB 950 also mandated that DOJ provide investigative assistance to local law enforcement agencies to better insure the investigation of individuals who continue to possess firearms despite being prohibited from doing so. (Penal Code § 30010) DOJ states that its special agents have trained approximately 500 sworn local law enforcement officials in 196 police departments and 35 sheriff’s departments on how to use the database during firearms investigations. The department states it has also conducted 50 training sessions on how to use the vehicle-mounted California Law Enforcement Telecommunications System terminals to access the database.

Local law enforcement agencies are provided monthly information regarding the armed and prohibited persons in the agency’s jurisdiction. Given this access, once the armed and prohibited person is identified, DOJ and local agencies could coordinate to confiscate the weapons. However, at the present time, many agencies are relying on assistance from DOJ’s criminal intelligence specialists and special agents to work APPS cases. When local agencies do confiscate weapons, they are required to send DOJ a notice so that the individual can be removed from the list.

In 2013, the Legislature, in coordination with DOJ, determined that there was a significant workload resource gap. At that time, it was estimated that approximately 2,600 offenders were added to the APPS list annually, creating a significant backlog in the number of investigations. According to DOJ, each special agent is capable of conducting 100 APPS investigations over a one-year period. During fiscal year 2012-13, the Bureau of Firearms had authority for 21 agents. Therefore, the bureau was capable of conducting roughly 2,100 investigations on an annual basis with that special agent authority, which would add 500 possible armed and prohibited persons to the backlog each year. The DOJ’s Bureau of Firearms workload history is provided below.

**Armed Prohibited Persons  
Workload History**

<b>Fiscal Year</b>	<b>Armed and Prohibited Persons Identified</b>	<b>APPS Investigations Processed</b>
2007-08	8,044	1,620
2008-09	11,997	1,590
2009-10	15,812	1,763
2010-11	17,606	1,700
2011-12	18,668	1,716
2012-13	21,252	2,772
2013-14	22,780	4,156
2014-15	17,479	7,573

To address the workload resources required to both reduce the growing backlog, and actively investigate incoming cases in a timely fashion, the Legislature passed SB 140, (Leno), Chapter 2, Statutes of 2013. SB 140 provided DOJ with \$24 million from the Dealer’s Record of Sale (DROS) account in order to increase regulatory and enforcement capacity within DOJ’s Bureau of Firearms. The resources financed in SB 140 were provided on a three-year limited-term basis, which, according to the DOJ, was adequate time to significantly reduce or eliminate the overall number of armed and prohibited persons in the backlog. Ongoing cases could be managed with

resources within DOJ's Bureau of Firearms. Additionally, the measure included reporting requirements due annually to the Joint Legislative Budget Committee.

During the 2015 budget hearing process last spring, the Legislature expressed concern that half-way through the three years, the department had spent 40 percent of the \$24 million, and the backlog had only been reduced by approximately 3,770. In addition, the Bureau of Firearms had hired 45 agents, as of the date of their update, but had only retained 18 agents. Of the agents that left the bureau, the vast majority went to other agent positions in DOJ. It is unclear what caused this staff retention issue, whether it was due to the fact that the new positions were limited-term or that more senior agents were permitted to transfer. As a result, some SB 140 funding that was intended to directly address the APPS backlog was instead used to conduct background checks, provide training and to equip newly hired who agents subsequently left the bureau.

**2015 Budget Actions.** The 2015 Budget Act provided DOJ's Bureau of Firearms with 22 additional permanent positions dedicated to APPS investigations and required that they be funded utilizing existing resources. In addition, supplemental reporting language required DOJ to provide the Legislature, no later than January 10, 2016, an update on the department's progress on addressing the backlog in the APPS program and hiring and retaining investigators in the firearms bureau.

**DOJ APPS Backlog Supplemental Report.** *The Senate Bill 140 Supplemental Report of the 2015-16 Budget Package* submitted by DOJ notes that as of December 31, 2015, the department had addressed a combined total of 33,264 prohibited persons in the APPS database since July 1, 2013. However, as of the end of December 2015, 12,691 people remained of the 21,249 person backlog identified on January 1, 2014. DOJ has committed to eliminating the entire backlog by December 2016. However, given their current pace, it is unclear how they will achieve that goal in the next 11 months.

As noted above, the report also required DOJ to address concerns raised by the Legislature surrounding the high turnover and vacancy rate among agents in the firearms bureau. The department notes that they continue to have vacancies but have taken steps to retain agents, including instituting a 24-month transfer freeze for new agents. The department currently has 73 agent positions dedicated to APPS enforcement. As of July 1, 2015, 57 of the 73 positions were filled. However, rather than making progress in filling vacant positions, by December 31, 2015, there were a total of 75 agents positions dedicated to APPS but only 54 of them were filled, leaving 21 vacancies.

Despite on-going challenges associated with eliminating the APPS backlog and retaining agents, the department notes that between July 1, 2013 and October 31, 2015, approximately 18,608 cases had been closed at an average cost of \$775 per case. In addition, during the same reporting period (July 1, 2013 through December 31, 2015) the firearms bureau recovered 9,732 firearms, almost 950,000 rounds of ammunition, 6,425 magazines, and 9,475 large capacity magazines.

**California State Auditor Report.** In addition to concerns raised by the Legislature, on July 9, 2015, the State Auditor released a follow-up report to an audit of the APPS program conducted in 2013. Along with other concerns raised in that report, the most recent auditor report noted

little or no progress in reducing the backlogs in DOJ's processing queues—the daily queue and a historical queue—noted in the State Auditor's 2013 report. Specifically:

- During late 2012 and early 2013, DOJ had a backlog of more than 1,200 matches pending initial review in its daily queue—a queue that contains the daily events from courts and mental health facilities that indicate a match and could trigger firearm ownership prohibition. Because a backlog in this queue means that DOJ is not reviewing these daily events promptly, the Auditor recommended that DOJ establish a goal of no more than 400 to 600 cases in the daily queue. In the most recent audit, the Auditor found that DOJ's daily queue during the first quarter of 2015 was over 3,600 cases—six times higher than its revised ceiling of 600 cases. Just as it did during the previous audit, DOJ cites its need to redirect staff to another Bureau of Firearms priority, which has a statutory deadline, as the reason for the continuing backlog. The Auditor believes that, if DOJ had a statutory deadline on the initial processing of the matches in the APPS database, it would encourage DOJ to avoid redirecting APPS unit staff. The chief of the bureau believes that seven days is a reasonable time frame to complete an initial review of matches.
- DOJ is unlikely to complete its review of events in the historical queue by its December 2016 goal, set forth in the October 2013 audit report. The former assistant bureau chief explained that the backlog in Justice's historical queue consists of persons who registered an assault weapon since 1989 or acquired a firearm since 1996 and who have not yet been reviewed for prohibiting events since DOJ implemented the APPS database in November 2006. In the previous report, the Auditor reported that as of July 2013, DOJ's historical backlog was nearly 380,000 persons; now as of April 2015, its historical backlog was still over 257,000 potentially prohibited persons. Based on DOJ's annual averages of reviewing the historical backlog since 2010, the Auditor estimates that DOJ will not complete its review of the historical backlog until 2018, based on DOJ's most productive year. Based on its current pace of completion, the review would not be complete until 2022. The longer it takes DOJ to review the records in historical backlog, the longer armed prohibited persons keep their firearms, which increases the risk to public safety.

In response to the report, DOJ stated:

*APPS grows by approximately 3,000 persons per year, but California local law enforcement does not have sufficient resources to proactively locate and contact armed and prohibited persons. To address this problem, Attorney General Harris sponsored Senate Bill 819 in 2011 to fund increased enforcement efforts. After its enactment, Attorney General Harris ordered a series of sweeps that successfully took firearms out of the possession of persons prohibited due to their criminal histories or mental health. After the success of these sweeps, Attorney General Harris sought and received additional resources from the Legislature in July 2013, via Senate Bill 140, to hire 36 additional agents for the APPS program. This has enabled the DOJ to conduct 13,313 APPS investigations from July 1, 2013, to May 30, 2015, and reduced the APPS subject backlog from an estimated 28,000 subjects (if not for the additional resources acquired via SB 140) to 15,797 APPS subjects as of June 19, 2015. That is a net reduction of more than 12,000 subjects.*

*DOJ is committed to eliminating the APPS historical backlog by December 2016. As previously indicated, the DOJ has continued to monitor and respond to workload fluctuations impacting APPS processing. Additionally, the DOJ did establish realistic goals to complete the backlog by December 31, 2016. However, the unforeseen loss of analytical staff, and the continued high level of firearms sales have forced the DOJ to redirect staff to meet the legislative time frames associated with completing background checks on firearm purchases in California. The DOJ agrees with this recommendation and is currently in the process of implementing a strategy to temporarily redirect staff from other areas of the department to assist with the historical backlog and for adding analytical staffing resources to the BOF to meet workload demands, thereby eliminating the need to redirect staff away from the goal of eliminating the APPS historical backlog by December 31, 2016.*

In addition to the above response to the Auditor's follow-up report, DOJ provided an update in its recent SB 140 Supplemental Report. As of January 1, 2016, the historical backlog had been reduced to 122,566.

## GOVERNOR'S PROPOSAL

The budget proposes an on-going increase of \$4.7 million in Firearms Safety and Enforcement Special Fund (FS&E) to provide permanent funding for 22 positions for APPS investigations. Currently, all APPS related activities are funded through the DROS account. The DROS fund requires an appropriation from the Legislature. The FS&E fund is continuously appropriated. Therefore, if the proposed funding shift is approved, DOJ would not require future legislative authority to expend money deposited in the fund for APPS.

## ISSUES TO CONSIDER

**Seek Assistance from Other Statewide Entities.** Given the on-going struggle of DOJ to fill investigative positions in their firearms bureau and to process the APPS backlog and assess new cases, the Legislature may want to consider creating a partnership between DOJ and other statewide law enforcement entities—like the California Highway Patrol (CHP)—to investigate prohibited persons and firearms trafficking cases, and retrieve prohibited firearms and ammunition. DOJ currently focuses on a geographic region of the state for its APPS investigations, rather than prioritizing new cases throughout the state that may be easier to resolve. The CHP has officers stationed widely throughout the state. This partnership may allow the state to prioritize cases based on time in the system, rather than geographic region, thus resolving cases more quickly.

**Prohibit the Transferring of Resources From One Program Area to Another.** One problem raised during discussions surrounding DOJ's efforts to investigate firearms and in the Auditor's follow-up report, is that the department appears to shift or loan both sworn and non-sworn staff among their various bureaus and programs in order to increase the number of investigations in one area versus another area. The Legislature may wish to restructure the DOJ budget to prohibit or restrict the movement of personnel and funding from one area to another.

**Should DOJ Increase the DROS Fee?** Under current law, the DROS fund is intended to provide DOJ with the funding necessary for all firearms-related regulatory and enforcement activities related to the sale, purchase, possession, loan or transfer of firearms. Should the fee prove insufficient, DOJ has the authority to increase the fee at a rate not to exceed the Consumer Price Index (CPI). (Penal Code § 28225) The Legislature may wish to suggest that DOJ increase the DROS fee, rather than authorizing use of the FS&E fund for APPS-related activities. Should the CPI prove to be an inadequate increase, DOJ may wish to propose a statutory change allowing them to increase the fee beyond the CPI.

**Remove Continuous Appropriations.** As noted above, the DROS fund requires an appropriation from the Legislature for all expenditures; the other two firearms-related funds do not. Allowing other branches of government to spend funds without legislative authority or appropriation potentially erodes the Legislature's constitutional authority to establish policy priorities and funding levels for the state. It has been a long-standing policy among the fiscal committees in both houses to limit or prohibit continuous appropriations. The Legislature may wish to consider removing the continuous appropriations from both the FS&E fund and the FSA fund, regardless of the Legislature's decision on the APPS funding proposal.

**Establish a Deadline for Reviewing New Cases.** The State Auditor has recommended that the Legislature require DOJ complete an initial review of cases in the daily queue within seven days and periodically reassess whether DOJ can complete these reviews more quickly. The Auditor believes that this would ensure that DOJ fairly balances competing responsibilities and avoids redirecting APPS unit staff to conduct Dealers' Record of Sale background checks.

**Require a Detailed Accounting of SB 140 Expenditures.** Despite budget hearings and staff discussions with DOJ, it remains unclear how DOJ spent the additional \$24 million in DROS funds even though they were largely unable to fill the additional investigator positions for which the funding was intended. Prior to approving on-going, new funding for APPS, the Legislature may want to require a complete written accounting of exactly how the \$24 million was spent.

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## TIMELINE FOR THE 2016-17 BUDGET BILL

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Thursday	January 7	Governor submits State Budget to the Legislature.
Thursday	January 7	Committee releases <i>Summary of Governor's Proposed 2016-17 Budget</i> .
Monday	January 11	Legislative Analyst submits <i>Overview of the Governor's Budget</i> .
Tuesday	January 19	Committee conducts overview hearing of the Governor's Proposed 2016-17 Budget.
Monday	February 8	Committee releases <i>Overview of the 2016-17 Governor's Budget</i> .
Thursday	February 18	Full Budget Committee holds oversight hearing on Cap-and-Trade: Addressing Legislative Budget Priorities
Thursday	February 25	Full Budget Committee holds oversight hearing on Homelessness in California's Local Communities.
Monday	February 29	Full Budget Committee holds oversight hearing on Examining California's Child Care and Early Learning System.
Thursday	March 3	Subcommittee budget hearings begin.
Friday	April 1	Department of Finance submits Finance Letters.
Thursday	March 17	Spring Recess begins.
Monday	March 28	Legislature reconvenes from Spring Recess.
Thursday	May 12 (est.)	Governor delivers May Revision to the Legislature.
Wednesday	June 15	Legislature must pass budget to meet constitutional deadline for passage of the budget.
Thursday	June 30	Governor signs 2016-17 Budget

# STAFF ASSIGNMENTS

BUDGET CONDITION	MARK IBELE FARRA BRACHT
CORRECTIONS/PUBLIC SAFETY	JULIE SALLEY-GRAY
EDUCATION	
K-12 EDUCATION	ELISA WYNNE
HIGHER EDUCATION	ANITA LEE
EARLY CHILDHOOD EDUCATION	SAMANTHA LUI
ENERGY	FARRA BRACHT
ENVIRONMENTAL PROTECTION	CATHERINE FREEMAN
HOUSING AND COMMUNITY DEVELOPMENT	FARRA BRACHT
JUDICIARY	JULIE SALLEY-GRAY
LABOR & EMPLOYEE COMPENSATION	ANITA LEE
LOCAL GOVERNMENT	MARK IBELE
HEALTH	MICHELLE BAASS
HUMAN SERVICES	THERESA PEÑA MICHELLE BAASS
RESOURCES	CATHERINE FREEMAN
TAXES AND REVENUES	MARK IBELE
STATE ADMINISTRATION	SAMANTHA LUI MARK IBELE
TRANSPORTATION	FARRA BRACHT
VETERANS AFFAIRS	SAMANTHA LUI
COMMITTEE SECRETARY	SANDY PEREZ
COMMITTEE ASSISTANT	MARY TEABO

## CALIFORNIA STATE BUDGET HISTORY

Fiscal Year	Bill and Chapter No.	Date Passed and Chaptered		Total Budget (\$ Billions)
1965-66	AB 500/757	6-18	6-30	4.0
1966-67 <sup>a</sup>	SB 1XX/2	6-30	6-30	4.7
1967-68	AB 303/500	6-29	6-30	5.0
1968-69	SB 240/430	6-28	6-29	5.7
1969-70	SB 255/355	7-3	7-3	6.3
1970-71	AB 525/303	7-4	7-4	6.6
1971-72 <sup>b</sup>	SB 207/266	7-2	7-3	6.7
1972-73 <sup>c</sup>	SB 50/156	6-15	6-22	7.4
1973-74	AB 110/129	6-28	6-30	9.3
1974-75	SB 1525/375	6-28	6-30	10.3
1975-76	SB 199/176	6-26	7-1	11.5
1976-77	SB 1410/320	7-1	7-2	12.6
1977-78	AB 184/219	6-24	6-30	14.0
1978-79	AB 2190/359	7-5	7-6	18.8
1979-80	SB 190/259	7-12	7-13	21.5
1980-81	AB 2020/510	7-16	7-16	24.5
1981-82 <sup>c</sup>	SB 110/99	6-15	6-28	25.0
1982-83	AB 21/326	6-30	6-30	25.3
1983-84	SB 123/324	7-19	7-21	26.8
1984-85 <sup>c</sup>	AB 2313/258	6-15	6-27	31.0
1985-86 <sup>c</sup>	SB 150/111	6-13	6-28	35.0
1986-87 <sup>c</sup>	AB 3217/186	6-12	6-25	38.1
1987-88	SB 152/135	7-1	7-7	40.5
1988-89	AB 224/313	6-30	7-8	44.6
1989-90	SB 165/93	6-29	7-7	48.6
1990-91	SB 899/467	7-28	7-31	51.4
1991-92	AB 222/118	6-20/7-4	7-16	55.7
1992-93	AB 979/587	8-29	9-2	57.0
1993-94	SB 80/55	6-22	6-30	52.1
1994-95	SB 2120/139	7-4	7-8	57.5
1995-96	AB 903/303	8-2	8-3	56.8
1996-97	SB 1393/162	7-8	7-15	61.5
1997-98	AB 107/282	8-11	8/18	67.2
1998-99	AB 1656/324	8-11	8-21	71.9
1999-00	SB 160/50	6/16	6/29	81.3
2000-01	AB 1740/52	6/22	6/30	99.4
2001-02	SB 739/106	7/21	7/26	103.3
2002-03	AB 425/379	9/1	9/5	98.9
2003-04	AB 1765/157	7/29	8/2	98.9
2004-05	SB 1113/208	7/29	7/31	105.3
2005-06	SB 77/38	7/7	7/11	117.3
2006-07	AB 1801/47	6/27	6/30	131.4
2007-08	SB 77/171	8/21	8/24	146.5
2008-09	AB 1781/268 & AB 88/269	9/16	9/23	144.5
2009-10	SBx3 1/Ch 1 & ABx4 1/Ch 1	2/20 – 7/23	2/19 - 7/28	119.2
2010-11	SB 870/Ch 712	10/7	10/8	125.3
2011-12	SB 87/Ch 33	6/28	6/30	129.5
2012-13 <sup>c</sup>	AB 1464/Ch 21 & AB 1497/Ch 29	6/15	6/27	142.4
2013-14 <sup>c</sup>	AB 110/Ch 20	6/14	7/1	145.3
2014-15 <sup>c</sup>	SB 852/Ch. 25	6/15	6/20	156.4
2015-16 <sup>c</sup>	AB 93/Ch 10, SB 97/Ch 11, and SB 101/Ch 321	6/15, 6/19 9/11	6/19, 6/24 and 9/22	167.6

<sup>a</sup> 1966 Second Extraordinary Session.

<sup>b</sup> First year budget was to be enacted by June 15.

<sup>c</sup> June 15 constitutional deadline met (8).

## General Fund Revenues at 2016-17 Governor's Budget

(Dollars in Millions)

	2015-16	2016-17	2017-18	2018-19	2019-20
<b>1 Major Revenues</b>					
2 Alcoholic Beverage Taxes and Fees	366	373	379	386	393
3 Corporation Tax	10,304	10,956	11,600	12,120	12,693
4 Cigarette Tax	84	81	79	77	75
5 Insurance Gross Premiums Tax	2,493	2,549	2,608	2,668	2,729
6 Mobile Home in-lieu Tax	1	1	1	1	1
7 Personal Income Tax	81,354	83,841	86,357	84,472	86,357
8 Retail Sales and Use Taxes	25,246	25,942	26,422	27,610	28,907
<b>9 Total Major Revenues</b>	<b>\$119,848</b>	<b>\$123,743</b>	<b>\$127,446</b>	<b>\$127,334</b>	<b>\$131,155</b>
<b>10 Minor Revenues/Transfers</b>					
11 Misc Revenue from Local Agencies	165	170	170	170	170
12 Income from Pooled Money Investments	36	89	170	251	265
13 State Lands Royalties	36	101	98	63	50
14 Abandoned Property	419	431	423	428	457
15 Miscellaneous Revenue	137	104	104	104	104
16 Tribal Gaming Revenues	247	183	183	183	183
17 Penalty Assessments - Other	341	28	28	28	28
18 Loan Repayments to Other Funds	-1,373	-891	-524	-240	0
19 All Other Transfers and Loans	293	2	-203	-248	-515
20 Transfer to BSA for Rainy Day Funds	-2,849	-3,556	-1,284	-999	-991
21 Remaining Others	237	229	230	231	232
<b>22 Total Minor Revenues/Transfers</b>	<b>-\$2,311</b>	<b>-\$3,110</b>	<b>-\$605</b>	<b>-\$29</b>	<b>-\$17</b>
<b>23 Total Revenues and Transfers</b>	<b>\$117,537</b>	<b>\$120,633</b>	<b>\$126,841</b>	<b>\$127,305</b>	<b>\$131,138</b>

**General Fund Multi-Year N98 Expenditures by Agency  
at 2016-17 Governor's Budget  
(Dollars in Millions)**

	2015-16	2016-17	2017-18	2018-19	2019-20
<b>N98 excludes Capital Outlay, Debt Service</b>					
Legislative, Executive	\$1,225	\$1,215	\$1,186	\$1,174	\$1,174
Courts	1,855	1,972	1,923	1,937	1,952
Business, Consumer Services, and Housing	37	30	30	30	30
Transportation	84	4	-	-	-
Natural Resources	1,694	1,782	1,434	1,452	1,380
Environmental Protection	321	-39	72	69	69
Health and Human Services	31,511	33,472	36,753	39,316	41,466
Affordable Care Act County Offset	(-742)	(-413)	(-564)	(-564)	(-564)
Federal Funds Offset <sup>1/</sup>	(-125)	(0)	(0)	(0)	(0)
Corrections and Rehabilitation	9,730	10,127	9,966	9,974	9,970
AB 109 Savings	(-1,544)	(-1,544)	(-1,544)	(-1,544)	(-1,544)
Receiver's Costs	(1,882)	(1,921)	(1,947)	(1,972)	(1,997)
Education	11,157	11,890	12,747	13,231	13,924
STRS Contribution	(1,935)	(2,468)	(2,545)	(2,623)	(2,704)
PERS Contribution (GF) (CSU Only)	(584)	(636)	(655)	(673)	(694)
Labor and Workforce Development	212	166	110	41	41
Government Operations	761	745	733	716	710
General Government	1,882	3,118	3,240	3,986	4,695
Non-Agency Departments	(650)	(666)	(645)	(607)	(595)
Tax Relief/Local Government	(445)	(483)	(446)	(446)	(446)
Statewide Expenditures	(787)	(1,969)	(2,149)	(2,933)	(3,654)
PERS Contribution (GF) (State Only)	(2,281)	(2,534)	(2,666)	(2,807)	(2,957)
Item 9800 Employee Compensation	(0)	(27)	(78)	(114)	(156)
Item 9901 Employee Compensation Placeholder	(0)	(300)	(550)	(950)	(1,250)
<b>Capital Outlay</b>	176	1,648	204	92	219
<b>Debt Service</b>	5,427	5,507	5,498	5,724	5,697
<b>Total N98 Expenditures</b>	<b>\$66,072</b>	<b>\$71,637</b>	<b>\$73,896</b>	<b>\$77,742</b>	<b>\$81,327</b>

<sup>1/</sup> Hospital finance waiver (Bridge to Reform) expired in 2015.

**General Fund Prop 98 Expenditures  
at the 2016-17 Governor's Budget**

(Dollars in Millions)

	2015-16	2016-17	2017-18	2018-19	2019-20
Proposition 98 guarantee (GF)	40,907	41,845	44,328	46,011	52,183
Education Protection Account	9,085	9,127	7,722	5,106	
Local Property Tax	19,183	20,613	21,804	22,949	24,135
<b>Total Prop 98 guarantee</b>	<b>69,175</b>	<b>71,585</b>	<b>73,854</b>	<b>74,066</b>	<b>76,318</b>
Percent Change to Prior-year	3.73%	3.48%	3.17%	0.29%	3.04%
Prop 98 Test	2	3	3	3	3
General Fund Base	40,907	41,845	44,328	46,011	52,183
Education Protection Account	9,085	9,127	7,722	5,106	0
QEIA Payment	0	0	0	0	0
Williams Settlement	(273)	0	0	0	0
Settle-Up for Old Years	(256)	(257)	286	337	352
Mandate Payments	(1,037)	(260)	(286)	(337)	(352)
<b>Total General Fund</b>	<b>49,992</b>	<b>50,972</b>	<b>52,336</b>	<b>51,454</b>	<b>52,535</b>
<b>Prop 98 Obligations</b>					
Maintenance Factor Created/Paid (+/-)	-810	548	1,318	2,445	191
Maintenance Factor Balance Prior to Proposition 2	0	0	0	0	0
Maintenance Factor Balance After Proposition 2	0	548	1,893	4,407	4,743
Settle-Up Balance	1,232	975	689	352	0
Budgetary Deferrals Balance	0	0	0	0	0
QEIA Balance	0	0	0	0	0
Mandate Balance	2,625	1,839	1,722	1,600	1,486
Williams Settlement Balance	0	0	0	0	0

## General Fund Multi-Year Forecast at 2016-17 Governor's Budget

(Dollars in Millions)

	2015-16	2016-17	2017-18	2018-19	2019-20
<b>RESOURCES:</b>					
Prior Year Balance	\$3,699	\$5,172	\$3,196	\$3,805	\$1,914
Revenues/Transfers	\$120,386	\$124,189	\$128,125	\$128,304	\$132,129
Transfer to the Budget Stabilization Account <sup>1/</sup>	-\$2,849	-\$3,556	-\$1,284	-\$999	-\$991
<b>Total Resources</b>	<b>\$121,236</b>	<b>\$125,805</b>	<b>\$130,037</b>	<b>\$131,110</b>	<b>\$133,052</b>
<b>EXPENDITURES:</b>					
Proposition 98	\$49,992	\$50,972	\$52,336	\$51,454	\$52,535
Non-Proposition 98	\$66,072	\$71,637	\$73,896	\$77,742	\$81,327
Unallocated Prop 2 Debt Payments					\$123
<b>Total Expenditures</b>	<b>\$116,064</b>	<b>\$122,609</b>	<b>\$126,232</b>	<b>\$129,196</b>	<b>\$133,985</b>
<b>FUND BALANCES:</b>					
	\$5,172	\$3,196	\$3,805	\$1,914	-\$933
Reserve for Encumbrances	\$966	\$966	\$966	\$966	\$966
Special Fund for Economic Uncertainties	\$4,206	\$2,230	\$2,839	\$948	-\$1,899
Budget Stabilization Account/Rainy Day Fund	\$4,455	\$8,011	\$9,295	\$10,294	\$11,285
BSA balance as a percentage of General Fund tax proceeds	3.7%	6.5%	7.3%	8.1%	8.6%
Operating Surplus/Deficit with BSA Transfer	\$1,473	-\$1,976	\$609	-\$1,891	-\$2,847

1/ Includes additional \$2 billion BSA transfer in 2016-17.

**Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2**  
**2016-17 Governor's Budget**  
(Dollars in Millions)

	Outstanding Amount at Start of 2016-17	Proposed Use of 2016-17 Pay Down	Proposed Use of 2017-18 Pay Down	Proposed Use of 2018-19 Pay Down	Proposed Use of 2019-20 Pay Down
<b>Budgetary Borrowing</b>					
Loans from Special Funds	\$1,806	\$955	\$559	\$292	\$0
Underfunding of Proposition 98—Settle-Up	1,232	257	286	337	352
Repayment of pre-Proposition 42 Transportation Loans	879	173	220	220	266
<b>State Retirement Liabilities</b>					
State Retiree Health	71,773	0	50	150	250
State Employee Pensions	43,291	0	0	0	0
Teacher Pensions <sup>1/</sup>	72,718	0	0	0	0
Judges' Pensions	3,358	0	0	0	0
Deferred payments to CalPERS	570	0	0	0	0
<b>University of California Retirement Liabilities</b>					
University of California Employee Pensions	10,786	171	169	0	0
University of California Retiree Health	17,270	0	0	0	0
<b>Unallocated Debt Payments</b>					123
<b>Total</b>	<b>\$223,683</b>	<b>\$1,556</b>	<b>\$1,284</b>	<b>\$999</b>	<b>\$991</b>

1/ The state portion of the unfunded liability for teacher pensions is \$14.916 billion.

**Prop 2 Rainy Day Fund  
2016-17 Governor's Budget**  
(Dollars in Millions)

	2016-17	2017-18	2018-19	2019-20
<b><u>1.5% of General Fund Revenues &amp; Transfers</u></b>				
1 General Fund Revenues and Transfers (before BSA transfer)	\$124,189	\$128,125	\$128,304	\$132,129
2 1.5% of General Fund Revenues & Transfers	\$1,863	\$1,922	\$1,925	\$1,982
<b><u>Capital Gain Revenues (Sec 20(b))</u></b>				
3 General Fund Tax Proceeds	\$124,154	\$127,970	\$127,835	\$131,678
4 Personal Income Taxes from Capital Gains	\$12,402	\$11,513	\$10,370	\$9,279
5 % of General Fund Tax Proceeds	10.0%	9.0%	8.1%	7.0%
6 8% of General Funds Tax Proceeds	\$9,932	\$10,238	\$10,227	\$10,534
7 Personal Income Taxes from Capital Gains in Excess of 8% General Fund Tax Proceeds	\$2,470	\$1,275	\$143	\$0
8 Prop 98 Share of Capital Gains Tax Revenue above 8%	\$1,221	\$629	\$71	\$0
9 Non 98 Share of Capital Gain Tax Revenue above 8%	\$1,249	\$646	\$72	\$0
10 Total Available (Lines 2 and 9)	\$3,112	\$2,568	\$1,997	\$1,982
11 <b>Debt Repayment (50%)</b>	<b>\$1,556</b>	<b>\$1,284</b>	<b>\$999</b>	<b>\$991</b>
12 <b>Deposit to Rainy Day Fund (50%)</b>	<b>\$1,556</b>	<b>\$1,284</b>	<b>\$999</b>	<b>\$991</b>
13 <b>Additional Transfer to the BSA</b>	<b>\$2,000</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
14 <b>Cumulative Balance in Rainy Day Fund <sup>1/</sup></b>	<b>\$8,011</b>	<b>\$9,295</b>	<b>\$10,294</b>	<b>\$11,285</b>
15 <b>BSA Balance as a Percentage of General Fund Tax Proceeds</b>	<b>6.5%</b>	<b>7.3%</b>	<b>8.1%</b>	<b>8.6%</b>

<sup>1/</sup> Includes balance of \$1,606m from 2014-15, \$1,854m transferred in 2015-16, and \$995m 2015-16 true up.

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