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Agenda

January 17, 2017
10:00 a.m. - Room 4203

Overview of the Governor's 2017-18 Proposed Budget

- I. Presentations by:
- Amy Costa, Chief Deputy Director, Budget
Department of Finance
 - Mac Taylor, Legislative Analyst
Legislative Analyst's Office
- II. Public Comment

Attachments:

- A. Summary of the Governor's Proposed 2017-18 Budget
(Senate Committee on Budget and Fiscal Review)
- B. Overview of the Governor's 2017-18 Budget
(Legislative Analyst's Office)



COMMITTEE ON BUDGET & FISCAL REVIEW
Room 5019, State Capitol
Sacramento, CA 95814

SENATOR HOLLY J. MITCHELL, CHAIR

Summary of the Governor's Proposed 2017-18 Budget

January 10, 2017

The purpose of this Summary is to provide members and staff of the Legislature with an overview of the Governor's proposed budget for 2017-18. More detailed reviews of the proposals will be developed as the Committee reviews the proposals in public hearings. If you have questions, please contact the committee at (916) 651-4103.

Overall Budget Proposal

The Governor has proposed a budget for the 2017-18 fiscal year that includes resources—carry forward balance, revenues and transfers—of \$125.1 billion and expenditures of \$122.5 billion. Based on the budget proposal, the General Fund would end the 2017-18 fiscal year with an unencumbered reserve of over \$1.6 billion and include a deposit of \$1.2 billion to the Budget Stabilization Account (BSA), resulting in an expected balance in this account of over \$7.9 billion at the end of the budget year. In the Governor's budget, the Administration has identified an on-going annual budget problem of between \$1 and \$2 billion, largely stemming from slightly softening revenues. The budget proposes a variety of solutions to address this shortfall, which include pulling back on specified one-time spending commitments and tempering anticipated spending increases. For the budget year, the expected shortfall of \$1.6 billion is minor by historical standards, and accounts for about 1.3 percent of General Fund resources.

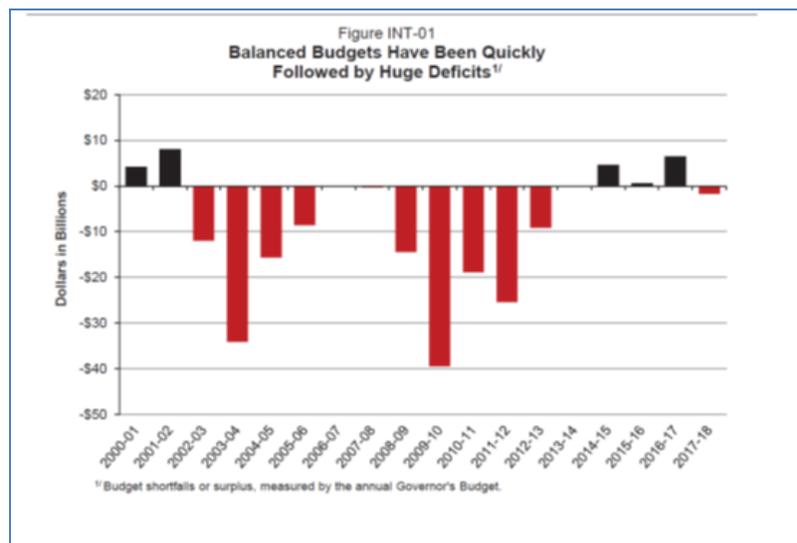
Despite the minor budget shortfall that has developed since the adoption of the 2016 Budget Act, the General Fund continues to be in a strong position, as a result of the combined efforts of the Administration and the Legislature over the last few years. In the budget, the state will continue its ongoing commitments to eliminate the overhang of budgetary borrowing as well as work to reduce longer term pension and retirement debt. Additionally, the budget proposes that, based on the slight revenue deterioration, expenditure adjustments be adopted. In total, from the 2016-17 adopted budget, revenues are down by about \$5.8 billion over the three year period (past year, current year and budget year). The proposed 2017-18 budget uses this adjusted base, incorporating a general reserve and BSA of approximately \$9.4 billion (with another almost \$1 billion reserved for encumbrances). Overall, General Fund spending in 2017-18 is expected to decline by \$241 million (or 0.2 percent) from the 2016-17 fiscal year; however the budget notes that spending requirements in core areas will continue to be addressed.

Overview of Governor's Budget Proposal

Overall Structure. The Governor's budget includes \$125.1 billion in General Fund revenues and other resources and \$122.5 billion in total General Fund expenditures (\$71.2 billion in non-Prop 98 and \$51.4 billion in Proposition 98), providing for a \$1.6 billion unencumbered reserve as well as setting aside an additional \$1.6 billion for the BSA. Expenditures in 2017-18 are proposed to be about \$241 million lower than revised 2016-17 expenditures. Additional funding is proposed for K-14 education and corrections and rehabilitation, with generally level funding in most areas of the budget. Budget resources have allowed for measured expansions and workload growth based on relatively stable revenues and one-time current year reductions. The General Fund budget details are summarized below.

2016-17 and 2017-18 General Fund Summary (Dollars in Millions)		
	Revised <u>2016-17</u>	Proposed <u>2017-18</u>
PRIOR YEAR BALANCE	\$5,023	\$1,027
Revenues and transfers	\$118,765	\$124,027
TOTAL RESOURCES AVAILABLE	\$123,788	\$125,054
Non-Proposition 98 Expenditures	\$72,431	\$71,169
Proposition 98 Expenditures	\$50,330	\$51,351
TOTAL EXPENDITURES	\$122,761	\$122,520
 FUND BALANCE		
Encumbrances	\$980	\$980
Special Fund for Economic Uncertainties	\$47	\$1,554
BUDGET STABILIZATION ACCOUNT	\$6,713	\$7,869

Addressing the Budget Shortfall. The budget shortfall identified by the Administration in the budget for 2017-18 is \$1.6 billion, representing about 1.3 percent of overall resources. This is relatively small compared to recent previous deficits and well-within the range of reasonable revenue estimation error that occurs with any state budget. For example, the deficit in 2009-10 approached \$40 billion, and the deficits addressed from 2008-09 through 2011-12 were all in excess of \$10 billion. The Department of Finance graphic below shows operating surpluses and deficits for the budget year and previous years.



Compared to the 2016 Budget Act, the two main factors causing this deficit are a revenue forecast that is \$5.8 billion lower than expected and a current-year shortfall in the Medi-Cal program. The deficit would be billions worse if not for the passage of a number of ballot measures at the November election, including Proposition 52 (hospital fee), Proposition 56 (tobacco tax), and Proposition 57 (prison reform). Proposition 55's extension of temporary income tax rates on the wealthiest Californians will begin to help balance the budget in 2018-19.

To address the forecasted shortfall, the Administration proposes expenditure solutions, largely focused on one-time savings and delays in implementation. The budget proposes \$3.2 billion in budget solutions, to address the shortfall and rebuild the general reserve. The major solutions proposed include:

- Adjust Proposition 98 (\$1.7 billion) - Appropriations made in 2015-16 and 2016-17 would over-appropriate the Proposition 98 minimum guarantee. The budget proposes adjustments designed to fund K-14 education at the

guarantee for 2015-16 through 2017-18. With these adjustments, overall K-14 funding still grows by \$2.1 billion for 2017-18.

- **Reduce or Eliminate 2016 Appropriations (\$0.9 billion)** - The 2016-17 budget contained a large package of one-time spending. Much of that spending remains uncommitted and the budget proposes to eliminate the authority to spend the dollars. The two largest components of this proposal are eliminating the \$400 million set-aside for affordable housing that was never allocated and a \$300 million transfer to modernize state office buildings planned for 2017-18.
- **Constrain Spending Growth (\$0.6 billion)** - The budget limits spending proposals to keep spending flat in 2017-18 compared to 2016-17, at about \$123 billion. This involves pausing rate increases for child care, not providing Middle Class Scholarships to any new students, and not submitting a variety of spending proposals (including those to implement new legislation) from state departments that otherwise were justified.

Current-Year Budget Highlights and Update

Adopted Budget. As adopted, the current year budget continued the restoration of essential educational, human services, and health programs, while maintaining the state's solid fiscal outlook. Specifically, the budget provides resources for many of the Legislature's priorities—especially in the areas of child care, human services, health, and education—within the established fiscal framework. The foundation for the plan largely began with the Governor's base level funding, but incorporated distinctive and important changes in program spending reflecting the Legislature's priorities. The current year budget includes funding for the following initiatives and programs:

Homelessness Initiative. The Senate's "No Place Like Home" initiative, is a multifaceted initiative to address homelessness and related issues. The plan includes a grant program funded through Proposition 63 revenue bonds for supportive housing. As part of this initiative, the budget includes more outreach to individuals with disabilities who may qualify for Supplemental Security Income (SSI), as well as additional resources for programs to reduce homelessness for CalWORKs families and for families that participate in the child welfare system. The plan also continues to fulfill the promise to rebuild the state's social safety net by reinvesting in CalWORKs through the elimination of the maximum family grant and by increasing the grant levels for maximum aid payment.

K-12 Education. In K-12 education, the budget continues to provide ongoing resources for the Local Control Funding Formula and one-time discretionary resources. To address the teacher shortage facing the state, there is additional funding for teacher recruitment, preparation, and retention. The plan funds a college readiness block grant, to ensure all students have the access and support needed to graduate and attend college.

Early Childhood Education. In child care and pre-school, the budget includes a major investment in childcare rate increases and pre-school slots, together totaling over \$500 million when fully phased-in over four years. These substantial increases are implemented as minimum wage increases in future years.

Higher Education. In higher education, the budget provides additional funds to enroll more undergraduate and graduate students at the University of California and the California State University systems, and incorporates the Senate's "College Readiness" program to assist low-income students attend and complete college. In addition, \$200 million more in Prop 98 funding is provided to community colleges to expand access to career technical education.

Housing Programs. In housing, the budget includes a tax credit program that will increase the effectiveness of affordable housing programs, adds enforcement staff to investigate housing discrimination complaints and facilitate compliance, adds a local government grant program that will facilitate the development of transitional housing for ex-offenders, and designates \$400 million for affordable housing, if subsequent legislation is agreed upon.

Health and Developmental Services. In health and developmental services, the budget augments programs for healthcare workforce development, limits estate recovery in the Medi-Cal program, restores acupuncture services as a benefit in the Medi-Cal program, provides funding for health programs such as drug overdose and hepatitis prevention, and creates a grant program for children's crisis services. The plan also improves the closure plans for the state developmental centers and improves oversight of the transition of developmental center residents into the community.

Human Services. In human services, the budget eliminates the CalWORKs maximum family grant, increases the SSI/SSP grant, provides augmentations for the Immigration Services Program and the Commercially Sexually Exploited Children Program, provides additional resources for the monitoring of psychotropic medications for foster youth, invests in senior nutrition programs and the State Emergency Food Assistance Program, and makes clarifications regarding the legal protections for immigrant youth.

Resources and the Environment. In resources and the environment, the budget continues oversight of the ongoing drought and statewide efforts to reduce water consumption. In addition, the budget provides oversight of the energy and utility ratepayer funds, expedites Aliso Canyon mitigation efforts, and provides funding for pest prevention studies in the Department of Pesticide Regulation.

Public Safety and Justice. In public safety and justice, the current year budget adheres to the Legislature's emphasis on positive programs to help individuals avoid the criminal justice system, rehabilitate incarcerated individuals, and facilitate the transition of ex-offenders to society through longer term and more effective programs. Among the priorities is to increase the availability of transitional housing, mental health and substance abuse treatment, and services for victims of domestic violence.

Recent Developments. Since the adoption of the 2016 Budget Act, there have been several significant expenditure changes, as discussed elsewhere in this report. These occur in K-12 education, health and human services and statewide expenditure, as shown below. In addition, there have been modest adjustments scattered throughout the budget. The difference between the adopted and revised current year budget are presented below.

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

Program Area	Adopted 2016-17	Revised 2016-17	Change	Percent Change
K-12 Education	\$51,277	\$50,589	-688	-1.34%
Higher Education	14,531	14,527	-4	-0.03%
Health and Human Services	33,240	35,263	2,023	6.09%
Corrections and Rehabilitation	10,571	10,889	328	3.10%
Business, Consumer Services, Housing	877	493	-384	-43.79%
Transportation	237	225	-12	-5.06%
Natural Resources	2,819	3,110	291	10.32%
Environmental Protection	88	90	2	2.27%
Labor and Workforce Development	176	177	1	0.57%
Government Operations	1,756	1,772	16	0.91%
General Government				
Non-Agency Departments	752	787	35	4.65%
Tax Relief / Local Government	474	459	-15	-3.16%
Statewide Expenditures	2,157	880	-1,277	-59.20%
Legislative, Judicial and Executive	3,513	3,500	-13	-0.37%
Total	\$122,468	\$122,761	\$293	0.24%

Proposed Budget Expenditures and Revenues

As noted, the proposed budget incorporates additional required programmatic increases and limited new spending. The table below summarizes the Governor's proposed expenditures by program area. The largest dollar changes in expenditures by program are in health and human services and K-12 education.

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

Program Area	Revised 2016-17	Proposed 2017-18	Change	% Change
K-12 Education	\$50,589	\$52,169	\$1,580	3.12%
Higher Education	14,527	14,627	100	0.69%
Health and Human Services	35,263	33,994	-1,269	-3.60%
Corrections and Rehabilitation	10,899	11,088	189	1.73%
Business, Consumer Services, Housing	493	388	-105	-21.30%
Transportation	225	243	18	8.00%
Natural Resources	3,110	2,811	-299	-9.61%
Environmental Protection	90	89	-1	-1.11%
Labor and Workforce Development	177	122	-55	-31.07%
Government Operations	1,772	741	-1,031	-58.18%
General Government				
Non-Agency Departments	787	691	-96	-12.20%
Tax Relief / Local Government	459	435	-24	-5.23%
Statewide Expenditures	880	1,800	920	104.55%
Legislative, Judicial and Executive	3,500	3,322	-178	-5.09%
Total	\$122,761	\$122,520	-\$241	-0.20%

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

Education

Education Funding. Estimated reductions in General Fund revenues reduce the Proposition 98 Guarantee in the 2015-16 and 2016-17 fiscal years, but there is still significant growth in Proposition 98 in 2017-18 over the 2016-17 years, resulting in a net increase in investments in K-14 education increase over the three-year period. The key changes in the education area include:

- **Early Education.** As a result of dampened General Fund revenues, the budget proposes to delay increases to child care and early education that were scheduled for 2017-18 as a result of the 2016 budget agreement. Specifically, the budget includes the full year costs of the increases in provider reimbursement rates and additional state preschool slots provided in 2016-17, but delays additional planned rate increases, cost-of-living increases, and state preschool slots from 2017-18 until 2018-19.
- **K-12 Schools.** Per student funding levels (from all fund sources) will increase to \$15,216 in 2017-18 from \$14,822 in 2016-17 (and from \$14,135 in 2015-16). Proposition 98 funding, although increasing by \$2.1 billion from 2016-17 (revised) to 2017-18 for a total of \$73.5 billion, was reduced in 2015-16 and 2016-17 from the 2016 Budget Act levels. These reduced guarantee levels means the state must reduce expenditures in these years to avoid over-appropriating the Proposition 98 guarantee. The budget proposes to accomplish this by deferring one-time and ongoing expenditures until the 2016-17 and 2017-18 years. In 2017-18, the bulk of new funding, in addition to paying off deferrals, is invested in transition funding for the Local Control Funding Formula (\$744 million in new funding in 2017-18) —funding approximately 96 percent of the formula.
- **Higher Education.** Despite lower than expected revenue growth, the budget continues to provide additional funding to the state's higher education system. Specifically, the budget creates a grant program to increase student success in community colleges, as well as continue the Administration's multi-year funding plan at UC and CSU. However, in order to support long-term stable growth in funding at UC and to maintain the Cal Grant program,

the Administration proposes to phase out the Middle Class Scholarship Program.

Health

Coordinated Care Initiative (CCI). The budget estimates that CCI will no longer be cost-effective and does not meet the statutory savings requirements. Therefore, the budget discontinues many components of CCI in 2017-18. The components proposed to be discontinued are: (1) remove IHSS benefits from plan capitation rates, (2) eliminate statewide authority responsible for bargaining IHSS workers' wages and benefits in the seven CCI counties; and (3) re-establish the state-county share of cost arrangement for the IHSS program that existed prior to the implementation of CCI. The net result of these three changes is a General Fund savings of \$626.6 million in 2017-18.

The budget notes that Cal MediConnect (the duals demonstration project and a component of CCI) has the potential to reduce the health care costs for individuals and improve health outcomes, and; consequently, proposes to extend the Cal MediConnect program. The budget reflects approximately \$20 million General Fund savings from the continuation of Cal MediConnect as allowed under federal law through December 31, 2019.

Affordable Care Act (ACA). Although the incoming presidential administration and leaders in Congress have suggested major changes to the ACA and Medi-Cal, the budget continues to reflect existing state and federal law. The budget notes that the Administration stands ready to play a constructive role to protect and enhance the lives and health of Californians.

Elimination of 2016 Budget Act Augmentations. The budget includes the elimination of certain health and human services General Fund augmentations included in the 2016 Budget Act.

Human Services and Housing

Housing and Disability Advocacy Program. The budget includes one-time savings of \$45 million General Fund in the current year from halting implementation of the Housing and Disability Advocacy Program, which was included in the 2016 Budget Act to incentivize local governments to boost outreach efforts and advocacy to get more eligible people enrolled in the SSI/SSP program.

Housing Programs. The budget eliminates the \$400 million set aside in the current year for affordable housing that was never allocated. In addition, The budget provides \$3.2 billion in various state and federal funding for housing affordability and homelessness programs. The budget also includes \$355 million in General Fund for debt service on previously-passed affordable housing bonds.

Transportation and Infrastructure

Transportation Funding Package. The budget proposes \$1.9 billion in 2017-18, and \$4.3 billion on an annual ongoing basis, for transportation funding and reform. The annual funding package provides \$2.1 billion from a new \$65 fee on all vehicles; \$1.1 billion by setting the gasoline excise tax at 21.5 cents (includes future adjustments for inflation); \$425 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 \$1.9 billion of additional funding in 2017-18 includes \$235 million from the acceleration of General Fund loan repayments over the next three years (\$706 million total), rather than repaying these loans over the next 20 years. The additional funding will be used for local streets and roads, transit and intercity rail capital projects, highway maintenance, the Active Transportation Program, and trade corridors.

Statewide Infrastructure Investments. The budget proposes to reduce by \$300 million the General Fund transfer to a new State Office Infrastructure Fund to be used for deferred renovation, or replacement of, state office buildings in the Sacramento region.

Resources, Environment and Energy

Cap-and-Trade Revenues. The budget proposes legislation, requiring a 2/3rds urgency vote, to confirm the Air Resources Board's authority to administer Cap and Trade auctions beyond 2020. Additionally, the budget proposes the following \$2.2 billion expenditure plan: (1) \$900 million continuously appropriated for state transit assistance (\$75 million), transit and intercity rail (\$150 million), the Sustainable Communities Strategy (\$300 million), and the state's high-speed rail project (\$375 million), and; (2) \$1.3 billion in discretionary funding for a variety of projects. This includes \$500 million for the Governor's transportation package and \$363 for the Air Resources Board's Low Carbon Transportation Program, as well as \$392 million for a variety of other greenhouse gas reducing programs.

Continued Drought Response. The budget proposes to build on previous years efforts to respond to drought impacts including: (1) \$5 million General Fund for the Department of Water Resources (DWR) to provide emergency drinking water support for small communities; (2) \$88 million General Fund and \$3 million from the State Responsibility Area Fund for CAL Fire to expand fire protection in the 2017 fire season (\$90 million General Fund in current year to initiate these enhancements); (3) \$52.7 million General Fund for the Office of Emergency Services to provide assistance to counties through the California Disaster Assistance Act, and; (4) \$2.6 million General Fund and \$900,000 from the Harbors and Watercraft Fund for the DWR to continue implementation of the state's Delta Smelt Resiliency Strategy.

Energy Programs. The budget includes \$953,000 from various funds to implement a variety of transparency reforms, and \$549,000 to improve governance and to collaborate with other agencies working on climate and energy issues.

Public Safety and Judicial

Proposition 57. The budget includes significant changes for the California Department of Corrections and Rehabilitation (CDCR) related to the passage of Proposition 57, which changed the calculation for parole, authorized an increase in credits for good behavior and participating in programming, and changed the way the determination is made regarding juveniles being tried as adults for certain crimes. The budget proposes \$5.7 million General Fund for the workload associated with the implementation of Proposition 57. In addition, the budget estimates a net savings of \$22.4 million General Fund in 2017-18, growing to a net savings of approximately \$140 million by 2020-21.

Inpatient Psychiatric Programs. The Department of State Hospitals (DSH) currently operates 1,156 inpatient mental health treatment beds at three California Department of Corrections and Rehabilitation (CDCR) prisons. The budget proposes transferring these programs to CDCR, effective July 2017. In addition, the budget redirects \$250.4 million and 1,977.6 positions from DSH to CDCR.

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 \$1.6 billion. This will result in a balance in the account at the conclusion on 2016-17 of \$7.9 billion, when combined with prior deposits to the fund. This would result in the BSA being funded to 63 percent of the constitutional target amount.

Debt Repayments. The budget continues to pay down the debt overhang as required under Proposition 2. Under the proposal, \$1.2 billion in Proposition 2 funds will pay off loans from special funds and past Proposition 98 liabilities. \$252 million will pay off budgetary borrowing from special funds, \$400 million for Proposition 98 settle-up costs, \$235 for pre-Proposition 42 transportation loans, and \$100 million for state retiree health. In addition, the Administration proposes a payment of \$169 million for University of California pension obligations.

General Fund Revenues

California relies on a broad range of taxes and other revenues to support the activities of the General Fund; however, the personal income tax, sales and use tax, and corporation taxes account for over 97 percent of General Fund revenues. For the budget year, the personal income tax is expected to generate \$85.9 billion (68.5 percent), the sales and use tax \$25.2 billion (20.1 percent), and the corporation tax \$10.9 billion (8.7 percent). As discussed, for the current, revenue in the major taxes are somewhat reduced from the 2016 Budget Act. California's economy and revenues are expected to continue to grow, although somewhat more slowly than assumed in the 2016 Budget Act. The General Fund revenue forecast has been reduced, reflecting lower growth in wages, proprietorship income, consumption, and investment. As a result, before accounting for transfers such as to the Rainy Day Fund, General Fund revenue is lower than the 2016 Budget Act projections for the period 2015-16 through 2017-18

Over the three year period, General Fund revenues are down by approximately \$5.8 billion from the 2016 Budget Act, or a modest 1.6 percent decline. From the current year to budget year, the major revenue sources are expected to grow by 3.3 percent for the personal income tax, 0.7 percent for the sales and use tax, and 4.7 percent for the corporation tax. Overall year-to-year revenue growth is estimated to be 2.7 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	2016-17	2017-18	Change	Percent Change
Personal Income Tax	\$83,136	\$85,866	2,730	3.28%
Sales and Use Tax	24,994	25,179	185	0.74%
Corporation Tax	10,389	10,878	489	4.71%
Insurance Tax	2,309	2,368	59	2.56%
Alcohol Beverage Tax	370	372	2	0.54%
Cigarette Tax	79	65	-14	-17.72%
Motor Vehicle Fees	24	24	0	0.00%
Other Taxes and Fees	648	431	-217	-33.49%
Subtotal	\$121,949	\$125,183	3,234	2.65%
Transfer to BSA	-3,184	-1,156	2,028	-63.69%
Total	\$118,765	\$124,027	\$5,262	4.43%

Overall Proposition 98 – K-14 Education

Budget Year – Overall Funding Levels – The budget estimates a total Proposition 98 funding level of \$73.5 billion (K-14). This is a \$1.6 billion increase over the 2016-17 Proposition 98 level provided in the 2016 Budget Act (a \$2.1 billion increase over the revised 2016-17 Proposition 98 level, as discussed below). The Administration estimates that the Proposition 98 calculation for 2017-18 will be a Test 3 calculation.

Prior – and Current Year Adjustments – The budget estimates that the total Proposition 98 guarantee (K-14) for 2015-16 decreased by \$379 million compared to the level estimated in the 2016 Budget Act (for a total of \$68.7 billion). Similarly, for 2016-17, the Governor estimates a decrease in the total guarantee of \$506 million (for a total of \$71.4 billion). These adjustments are the result of a decline in anticipated General Fund revenues over the three-year budget period and result in the over-appropriation of the Proposition 98 guarantee, absent actions to reduce appropriations in 2015-16 and 2016-17. (The Governor proposes to eliminate this over-appropriation by shifting or deferring expenditures from the 2015-16 and 2016-17 years to the 2016-17 and 2017-18 years, as discussed later in this section.) The Administration estimates that the Proposition 98 calculations for 2015-16 and 2016-17 are Test 3 calculations.

Proposition 98 Settle-Up – The budget includes \$400 million in Proposition 98 settle-up payments in the 2017-18 year that will count toward meeting the 2009-10 Proposition 98 minimum guarantee. The need for settle-up results when the Proposition 98 guarantee 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. After this payment, the state would owe \$626 million in settle-up for years prior to 2014-15.

Proposition 98 - K-12 Education – Major Spending Proposals – The budget includes a proposed Proposition 98 funding level of \$64 billion for K-12 programs. This includes a year-to-year increase of almost \$2 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2016-17. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from \$10,579 provided in 2016-17 (revised) to \$10,910 in 2017-18. This 2017-18 proposed Proposition 98 funding level for K-12 reflects a per-pupil increase of 3.1 percent, as compared to the revised per-pupil funding level provided for in 2016-17. The Governor's major K-12 spending proposals are identified below.

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). Since its inception, the state has dedicated a large portion of the new Proposition 98 revenues in each year towards full implementation of the LCFF. The 2016 Budget Act included \$2.9 billion in new Proposition 98 funds for LCFF implementation. However, the Governor's budget includes Proposition 98 estimates for 2015-16 and 2016-17 that are below the levels assumed in the 2016 Budget Act and, as a result, proposes to defer \$859.1 million of the funding scheduled to be provided for LCFF implementation from 2016-17 to 2017-18 (payments to local educational agencies would shift from June 2017 to July 2017). This would be a one-time deferral, fully paid off in the 2017-18 fiscal year. In addition to the one-year deferral, the Governor's budget proposes an increase of approximately \$744 million in 2017-18 to implement the LCFF. Overall, this investment results in the formula funded at 96 percent of full implementation in 2017-18, maintaining the same implementation percentage assumed as of the 2016 Budget Act. County offices of education reached full implementation with the LCFF allocation in the 2014 Budget Act.

Discretionary Funds / Mandate Backlog Reduction – The budget proposes an increase of \$287 million in discretionary one-time Proposition 98 funding provided to school districts, charter schools, and county offices of education. The Administration indicates that this funding 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. These funds would offset outstanding mandate reimbursement claims. In addition, as part of the actions taken to reduce the Proposition 98 appropriation levels, \$310 million in discretionary one-time Proposition 98 expenditures for school districts, charter schools, and county offices of education for these same purposes in 2015-16 are shifted to the 2016-17 year.

K-12 Special Education – The budget proposes to begin a series of stakeholder meetings during the spring budget process on the funding model for special education. In 2017-18, the budget proposes \$3.2 billion in Proposition 98 funding and \$1.2 billion in federal funds for special education. Unlike other categorical programs, funding for special education was not rolled into the funding for local educational agencies under the LCFF. Local educational agencies are required to operate as, or be a member of, a Special Education Local Plan Area (SELPA). The majority of funding for special education is provided to the SELPAs which distribute funds to member local educational agencies based on a locally-determined formula. The Governor's budget notes that stakeholder conversations would be centered on principals in alignment with the LCFF, including equity, transparency, flexibility, local control and focus on the needs of students.

K-12 School Facilities – In November, 2016, the voters passed the Kindergarten through Community College Facilities Bond Act of 2016 (Proposition 51), which authorizes the state to sell \$9 billion in general obligation bonds with the proceeds to be used for K-12 and community college facilities. The K-12 share of the proceeds, \$7 billion, would be subject to the rules of the state's existing school facilities program and could be used for new construction, modernization, career technical education facilities, and charter school facilities. The Administration notes concerns with the proper expenditure of funding from prior facilities bonds and proposes to strengthen program oversight and accountability prior to expenditure of the Proposition 51 bond funds. The Administration would accomplish this in two ways: (a) supporting the State Allocation Board and the Office of Public School Construction on revising and creating policies and

regulations; and, (b) introducing legislation requiring that the annual K-12 Audit Guide include facility bond expenditures.

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 \$168.9 million in 2016-17, as a result of a decrease in the projected average daily attendance (ADA), as compared to the 2016 Budget Act. For 2017-18, the Governor's proposed budget reflects a decrease of \$63.1 million to reflect a projected further decline in ADA for the budget year. (For charter schools, the Governor's proposed budget funds an estimated increase in charter school ADA – see “Other K-12 Education Budget Proposals” below.) The proposed budget also provides \$58.1 million to support a 1.48 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.

Other K-12 Education Budget Proposals

Career Technical Education Incentive Grant - The budget includes \$200 million in Proposition 98 funding for career technical education grants to local educational agencies. This is the final installment of funding for a three-year grant program adopted in the 2015 Budget Act.

Proposition 39 Energy Efficiency Investments – The budget proposes to allocate \$422.9 million in Proposition 39 energy funds available in 2017-18 to K-12 school districts and charter schools for energy efficiency project grants.

Charter Schools – The budget proposes an increase of \$93 million in Proposition 98 funds to reflect a projected increase in charter school ADA.

Special Education – The budget proposes a decrease of \$4.9 million in Proposition 98 funds to reflect a projected decrease in special education ADA.

Proposition 56 – The budget proposes \$29.9 million to support tobacco and nicotine prevention and reduction programs at K-12 schools. This funding is the result of an increase in taxes on tobacco products as a result of the passage of Proposition 56 in November 2016, which requires a percentage of the revenues to be available for school-based tobacco prevention programs.

Proposition 47 – The budget proposes \$10.1 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. SB 527 (Liu), Chapter 533 and AB 1014 (Thurmond), Chapter 397, Statutes of 2016 created a program for the expenditure of K-12 Proposition 47 funds. Pursuant to this legislation, the Department of Education will award grants to LEAs and provide training and technical assistance to grantees on pupil engagement, school climate, truancy reduction, and supporting pupils who are at risk of dropping out of school or who are victims of crime. This is a slight increase from the \$9.9 million estimate from this funding source included in the 2016 Budget Act.

Child Care and Early Education

The Governor's budget increases funding for child care and preschool programs by \$76 million (including Transitional Kindergarten), an increase of two percent from 2016-17; however, this includes several changes to the 2016-17 budget agreement. Specific adjustments are as follows:

Implementation of the 2016-17 Budget Agreement - As part of the 2016-17 budget package, the Legislature and the Governor agreed on a four-year plan to increase ongoing child care and preschool funding by roughly \$500 million (roughly \$200 million in Proposition 98 General Fund and \$300 million in non-Proposition 98 General Fund). In 2016-17, the state provided \$145 million for the first year of implementation (\$137.5 million for rates and \$7.8 million for 2,959 additional state preschool slots). Though not formalized in statute, the agreement for 2017-18 assumed: (1) annualization of the increases initiated the prior year, (2) 2,959 additional state preschool slots, and (3) \$86 million in non-Proposition 98 General Fund rate increases. The Governor's budget proposes suspending much of this agreement for 2017-18 and extending implementation of the plan through 2020-21. With respect to the Regional Market Rate (RMR) and Standard Reimbursement Rate (SRR), the Governor's budget proposes the following:

- **Regional Market Rate.** Annualizes funding for the January 1, 2017; increase of the RMR to the 75th percentile of the 2014 survey and the increase to the license-exempt rate for the Alternative Payment Program and all three CalWORKs stages. The additional 2017-18 cost; due to annualizing these previously approved rate increases, is \$68 million (\$57 million for the overall RMR and \$11 million for the license-exempt rate).

- **Standard Reimbursement Rate (SRR).** Does not provide funds for an additional five percent increase to complete the 10 percent increase initiated in 2016-17. The 2016 Budget Act included a 10 percent increase to the SRR that was to begin January 1, 2017. Because it is difficult for the California Department of Education (CDE) to implement a mid-year SRR increase, CDE gave a five percent increase to all providers at the start of the fiscal year, using the funds that the Legislature appropriated. The Governor's budget maintains this rate.

CalWORKs Child Care – The budget includes an overall year-to-year increase of about \$43 million to fund changes in CalWORKs child care rates, caseload, and the type of care selected. Specifically, the budget includes \$386 million for Stage 1, \$505 million for Stage 2 and, \$303 million for Stage 3. Funding for all three CalWORKS stages include the January 1, 2017 increase of the RMR to the 75th percentile of the 2014 survey. In addition, funding for both Stage 1 and especially Stage 2 reflect caseload increases, while Stage 3 reflects a decrease in caseload. Funding also reflects a decrease in the average cost of care, primarily driven by changes in Stage 1.

State Preschool and Transitional Kindergarten Funding and Slots. The budget also includes \$445 million for part-day state preschool; \$648 million for full-day state preschool, and \$714 million for transitional kindergarten. The budget includes \$24 million for annualizing the 2,959 full-day state preschool slots for local educational agencies that will begin April 1, 2017.

Child Care and Development Funds – The budget includes \$606 million in federal funds, a decrease of \$32 million federal funds over the previous year.

Other Policy Changes - The budget also proposes making various statutory changes to reduce the administrative burdens and better align child care and early education programs, these include:

- Increased flexibility for part-day state preschool programs to enroll children with special needs.
- Increased alignment of state preschool programs with transitional kindergarten programs related to staffing ratios and licensing requirements.

- Increased flexibility for school districts to determine the length of the transitional kindergarten day.
- Other changes to better streamline programs, including allowing families to submit electronic applications to receive subsidized child care or preschool and aligning the statutory definition of homelessness used for child care programs with the federal definition under the McKinney-Vento Act.

Higher Education

University of California

General Fund Increase – The budget proposes an increase of \$82.1 million unrestricted base increase, and \$50 million for graduate medical education provided by Proposition 56 (Cigarette and Tobacco Products Surtax Fund). The budget assumes UC will enroll 2,500 more resident undergraduates by 2017-18 and receive an associated \$18.5 million ongoing augmentation in 2016-17. The budget assumes a \$54 (five percent) increase in the Student Services Fee. The Governor does not propose enrollment targets or enrollment growth funding and assumes no increase in tuition.

One-time Funding to Pay Down Debts and Liabilities – The budget provides \$169 million one-time Proposition 2 funds to pay down the unfunded liability of the UC Retirement Plan. Consistent with the 2015 funding agreement, this is the final installment of a total of \$436 million in one-time funds provided over a three year period.

California State University

General Fund Increase – The budget proposes \$162.2 million (five percent) ongoing General Fund increase. The budget proposes (1) a \$131.2 million unallocated augmentation identical to UC's base increase, (2) an additional unallocated \$26 million associated with savings from changes to the Middle Class Scholarship program made in 2015-16, and (3) \$5 million for lease-revenue bond debt service. The Governor does not propose enrollment targets or enrollment growth funding and assumes no increase in tuition.

California Community Colleges

Please see the K-12 Education section of this report for additional information on the overall K-14 Proposition 98 budget.

Apportionments – The budget assumes a decrease of \$27.1 million Proposition 98 General Fund, which reflects: (1) an increase of \$94.1 million for a 1.48 percent cost-of-living adjustment, (2) an increase of \$79.3 million for enrollment growth (1.34 percent), (3) an increase of \$3.8 million as a result of decreased offsetting student enrollment fee revenues, (4) a decrease of \$56.6 million to reflect unused growth provided in 2015-16, and (5) a decrease of \$147.7 million as a result of increased offsetting local property tax revenues.

Guided Pathways – The budget provides \$150 million one-time Proposition 98 General Fund for grants to community colleges to develop an integrated, institution-wide approach to student success.

Operating Expenses – The budget provides an increase of \$23.6 million Proposition 98 General Fund to support community college operating expenses, such as employee benefits, facilities, professional development, and other general expenses.

Online Education Initiative – The budget provides an increase of \$10 million Proposition 98 General Fund to provide system-wide access to the initiative's learning management system.

Integrated Library System – The budget provides an increase of \$6 million one-time Proposition 98 General Fund to develop an integrated library system that would allow for students to access a cloud-based library system.

Deferred Maintenance – The budget proposes a \$43.7 million one-time Proposition 98 General Fund increase for deferred maintenance, instructional equipment, and specified water conservation projects. Community colleges will not need to provide matching funds for deferred maintenance.

Proposition 39 – The budget proposes an increase of \$3 million Clean Energy Job Creation Fund for community college energy efficiency projects, consistent with Proposition 39.

Innovation Awards – The budget proposes \$20 million one-time Proposition 98 General Fund for innovation awards for the development and implementation of innovative practices as determined by the Chancellor's Office.

Strong Workforce Program – The budget proposes to move \$48 million from the Career Technical Education Pathways program, which is scheduled to sunset on July 1, 2017, into the Strong Workforce Program.

Hastings College of the Law

General Fund Increase – The budget proposes an increase of \$1.1 million General Fund. The budget contains no enrollment targets, and assumes no changes in tuition levels.

Student Financial Aid

Middle Class Scholarship – The budget proposes a phase-out of the Middle Class Scholarship program, and as a result no new students would receive awards. The budget assumes General Fund spending on the program to remain flat at \$74 million from 2016-17 to 2017-18, whereas current law appropriates \$117 million in 2017-18. Students who received scholarships in 2016-17 would be eligible to renew scholarships.

Cal Grant Program Growth – The budget includes a decrease of \$52.4 million General Fund in 2016-17 and \$24.5 million General Fund in 2017-18 to reflect estimated costs.

Resources

Resources and the Environment

Cap-and-Trade Revenues – The budget proposes legislation, requiring a 2/3rds urgency vote, to confirm the Air Resources Board's authority to administer cap-and-trade auctions beyond 2020. Additionally, the budget proposes the following \$2.2 billion cap-and-trade expenditure plan: (1) \$900 million continuously appropriated for state transit assistance (\$75 million), transit and intercity rail (\$150 million), the sustainable communities strategy (\$300 million), and the state's high-speed rail project (\$375 million), and; (2) \$1.3 billion in discretionary funding for a variety of projects including \$500 million for the Governor's transportation

package and \$363 for the Air Resources Board's Low Carbon Transportation Program, as well as \$392 million for a variety of other greenhouse gas reducing programs.

Beverage Container Recycling Program Reform – The budget includes a framework for comprehensive reform of the Beverage Container Recycling Program based on three guiding principles: (1) improving recycling and remanufacturing; (2) shared responsibility; and (3) enhancing adaptability and sustainability. The Administration is proposing that this framework guide conversations of a stakeholder process that will be used to develop the final reform package.

Drought Response – The budget proposes to build on previous years efforts to respond to drought impacts including: (1) \$5 million General Fund for the Department of Water Resources (DWR) to provide emergency drinking water support for small communities; (2) \$88 million General Fund and \$3 million from the State Responsibility Area Fund for CAL FIRE to expand fire protection in the 2017 fire season (\$90 million General Fund in current year to initiate these enhancements); (3) \$52.7 million General Fund for the Office of Emergency Services to provide assistance to counties through the California Disaster Assistance Act, and; (4) \$2.6 million General Fund and \$900,000 from the Harbors and Watercraft Fund for the DWR to continue implementation of the state's Delta Smelt Resiliency Strategy.

Water Action Plan – The budget proposes the following adjustments to the California Water Action Plan: (1) \$248 million in Proposition 1 funding for the DWR for integrated regional water management projects; (2) \$1 million from the Waste Discharge Permit Fund and five positions for the State Water Board to address contamination of groundwater basins; (3) \$1.9 million in reimbursements for the Department of Fish and Wildlife to support initial outreach and technical review of the ecosystem benefits of water storage project proposals; (4) \$15 million (General Fund) for 29 existing positions to provide statewide technical assistance, and; (5) \$2.3 million from the Water Rights Fund and five positions and \$1.5 million in contract funds to enforce reporting requirements and protect local groundwater in specific basins that fail to form local governance structures.

Fish and Game Preservation Fund – The budget proposes \$12.4 million in additional revenue from commercial fish landing fees to support the Department of Fish and Wildlife's commercial fishing program, and a one-time redirection of \$10.6 million from the Lifetime License Account. This proposal is intended to

address a \$20 million deficit in the Fish and Game Preservation Fund and the Administration acknowledges the need for more permanent measures in the future.

State Parks Services – The budget proposes \$12.6 million from the State Parks and Recreation Fund and \$4 million from the Environmental License Plate Fund on a one-time basis to maintain existing service levels.

Department of Conservation – The budget proposes \$21.1 million from the Oil, Gas, and Geothermal Administrative Fund and two positions for the department to implement a centralized database system and \$2.2 million from the Soil Conservation Fund for the department to provide grants to local governments to develop agricultural lands conservation plans.

Public Utilities Commission Reform – The budget proposes \$953,000 from various funds to implement several transparency reforms as called for by SB 215 (Leno), Chapter 807, Statutes of 2016 and AB 1651 (Oberholte), Chapter 815, Statutes of 2016, and \$549,000 to improve governance and cross-agency collaboration with other departments working on energy and climate issues pursuant to SB 512 (Hill), Chapter 808, Statutes of 2016.

Transportation

Department of Transportation (Caltrans) Funding – The budget provides for total expenditures of \$10.9 billion by the Department. The primary sources of funding for the department are federal funds, state taxes on gasoline and diesel fuel, and vehicle weight fees (about \$9.4 billion), with additional funds from Proposition 1B bonds (about \$171 million), and reimbursements from local governments (about \$1.3 billion).

Increased Funding for Transportation Infrastructure – The budget proposes a transportation funding package that provides \$42.9 billion over the next ten years. This includes annualized revenue of \$1.1 billion per year by resetting the gas tax to 21.5 cents, eliminating the annual adjustment, and indexing it to inflation; \$2.1 billion per year from a new \$65 fee on all vehicles, including hybrids; \$425 million per year by increasing the diesel excise tax by 11 cents and indexing it to inflation; \$500 million in additional cap-and-trade funds; and the redirection of \$100 million in Caltrans efficiencies. It also includes a General Fund commitment to repay \$706 million in outstanding loans from transportation funds over the next three years.

The budget includes \$1.9 billion in dedicated resources for the Governor's transportation package, roughly \$1 billion of which is dedicated to local transportation projects. The budget includes almost \$1.1 billion of new revenue generated by a \$65 Road Improvement Charge, allocates \$500 million of cap-and-trade revenues to the Transit and Intercity Rail Capital and Active Transportation Programs, and redirects \$100 million in operational efficiencies at Caltrans. It also includes \$235 million in General Fund resources to accelerate the repayment of loans. In total, the Governor's transportation package allocates \$358 million for Trade Corridor Enhancement, \$351 million for state highway repairs and maintenance, \$300 million for the Corridor Mobility Improvement Program, which includes \$25 million for local planning grants. In addition to the funding in Caltrans' budget, the package provides \$485 million for the Transit and Intercity Rail Capital Program, \$206 million for local road repairs and maintenance, and \$100 million for greenhouse gas reduction projects in the Active Transportation Program.

Local Streets and Roads – The budget provides \$206 million to cities and counties for local road maintenance.

Transit and Intercity Rail Capital – The budget provides \$400 million from cap-and-trade revenues and \$85 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 \$309 million in Road Improvement charge funding and \$42 million from loan repayments for repairs and maintenance on the state highway system.

Trade Corridor Improvements – The budget provides \$250 million in Road Improvement Charge funding and \$108 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 and streamlining of project delivery by making various changes that include advancing project environmental mitigation, implementing more innovative procurement, piloting the use of innovative contracting methods for routine maintenance projects, and extending the sunset date for public-private partnerships through 2027.

High-Speed Rail – The budget provides capital outlay funding of \$552 million (\$475 million in cap-and-trade funds and \$77 million in Proposition 1A bond funds) for phase 1 of the blended system. It also proposes \$500 million in Proposition 1A resources to provide funds to local agencies for local/regional components of the high-speed train system.

Department of Motor Vehicles (DMV) Continued Implementation of AB 60 (Alejo), Chapter 524, Statutes of 2013 – The budget provides \$8.6 million in Motor Vehicle Account (MVA) and 91 positions in 2017-18 to continue implementation of AB 60, which allows DMV to accept applications for driver's licenses and ID cards from undocumented residents.

Implementation of 2016 Legislation – The budget provides \$1 million in Motor Vehicle Account for the implementation of new legislation, including \$730,000 and five positions for inspecting ignition interlock pursuant to SB 1046 (Hill), Chapter 783, Statutes of 2016 and \$294,000 for investigation workload related to the unlicensed auto dismantling task force created by AB 1858 (Santiago), Chapter 449, Statutes of 2016.

California Highway Patrol (CHP) – The budget proposes \$2.8 million in MVA funding to replace obsolete phone systems at the CHP Academy and Dignitary Protection offices; \$1.4 million in MVA funding and 14 positions to establish a Privacy and Risk Management program to protect personally identifiable information stored in CHP's IT infrastructure; and \$1.2 million in MVA funding and two positions to establish a new cloud-based disaster recovery system. It also provides \$169 million in MVA funding for facility replacement work in El Centro, Hayward, Humboldt, Keller Peak, Ventura, Quincy, Santa Barbara, and San Bernadino, as well as statewide planning activities for future needs.

Health and Human Services

The Governor's budget includes a total of \$154.6 billion (\$34 billion General Fund and \$120.6 billion other funds) for health and human services that serve low-income, vulnerable individuals and families.

Health

Department of Health Care Services (DHCS)

The budget proposes \$105.3 billion (\$19.6 billion General Fund) for DHCS.

Medi-Cal Program – The budget proposes total expenditures of \$102.6 billion (\$19.1 billion General Fund) for 2017-18. This is a seven percent increase in General Fund spending from the prior year. It is projected that Medi-Cal will serve about 14.3 million Medi-Cal eligible individuals. The budget assumes costs of \$20.1 billion (\$888 million General Fund) in 2016-17 and \$18.9 billion (\$1.6 billion General Fund) in 2017-18 for the 4.1 million Californians in the optional Medi-Cal expansion.

The budget includes increased expenditures of \$1.8 billion General Fund in 2016-17 compared to the 2016 Budget Act primarily due to a one-time retroactive payment of drug rebates to the federal government and a miscalculation of costs associated with the Coordinated Care Initiative in prior estimates.

Affordable Care Act (ACA) – Although the incoming presidential administration and leaders in Congress have suggested major changes to the ACA and Medi-Cal, the budget continues to reflect existing state and federal law. The budget notes that the Administration stands ready to play a constructive role to protect and enhance the lives and health of Californians.

Coordinated Care Initiative (CCI) – The budget estimates that CCI will no longer be cost-effective and does not meet the statutory savings requirements. Therefore, the budget discontinues many components of CCI in 2017-18. The components proposed to be discontinued are: (1) remove IHSS benefits from plan capitation rates; (2) eliminate statewide authority responsible for bargaining IHSS workers' wages and benefits in the seven CCI counties; and (3) re-establish the state-county share of cost arrangement for the IHSS program that existed prior to the implementation of CCI. The net result of these three changes is a General Fund savings of \$626.6 million in 2017-18.

The budget notes that Cal MediConnect (the duals demonstration project and a component of CCI) has the potential to reduce the health care costs for individuals and improve health outcomes, and; consequently, proposes to extend the Cal

MediConnect program. The budget reflects approximately \$20 million General Fund savings from the continuation of Cal MediConnect as allowed under federal law through December 31, 2019.

Tobacco Tax Increase (Proposition 56) – The budget includes five quarters of the tax revenues for expenditure in 2017-18 from the California Healthcare, Research and Prevention Tax Act of 2016, which increases the excise tax rate on cigarettes and tobacco products, effective April 1, 2017. The budget includes \$1.2 billion in these tax revenues for DHCS to support new growth in Medi-Cal expenditures.

Children's Health Insurance Program (CHIP) Reauthorization – The budget assumes the federal CHIP program is reauthorized by Congress at the 65 percent federal matching percentage effective October 1, 2017 and includes a General Fund cost of \$536.1 million to reflect this assumption. The ACA included a provision that allows the program's federal matching percentage to increase from 65 percent to 88 percent through 2019; however, the CHIP program is only authorized by the federal government through September 2017.

Full-Scope Medi-Cal Coverage to Undocumented Children – The budget includes \$279.5 million General Fund to provide full-scope benefits to approximately 185,000 undocumented children in Medi-Cal. This amount reflects the full-year costs for this program.

Newly Qualified Immigrant Benefits and Affordability Program – The budget proposes that all newly qualified immigrant adults eligible for state-only Medi-Cal be transitioned into a wrap program and a qualified health plan in the Health Benefit Exchange; effective January 1, 2018 (as authorized by SB 1 X1 (Hernandez), Chapter 4, Statutes of 2013). The budget includes \$48 million General Fund savings to reflect this transition.

Hospital Quality Assurance Fee Extension – The budget assumes General Fund savings of over \$1 billion in 2017-18 from the permanent extension of the existing hospital quality assurance fee, pursuant to Proposition 52 of 2016.

Drug Medi-Cal Organized Delivery System Pilot – The budget includes \$19.9 million (\$3.1 million General Fund) in 2016-17 and \$661.9 million (\$141.6 million General Fund) in 2017-18 to reflect implementation of the Drug Medi-Cal Organized Delivery System pilot program. A total of six counties are estimated to begin providing services in 2016-17 with an additional 10 counties in 2017-18.

Department of Public Health (DPH)

The budget proposes \$3.3 billion (\$132 million General Fund) for DPH.

Tobacco Tax Increase (Proposition 56) – The budget includes five quarters of the tax revenues for expenditure in 2017-18 from the California Healthcare, Research and Prevention Tax Act of 2016, which increases the excise tax rate on cigarettes and tobacco products, effective April 1, 2017. The budget includes \$223.5 million and 57 positions in 2017-18 for DPH's dental, law enforcement, and tobacco prevention programs funded from these new revenues.

Licensing and Certification – The budget includes \$1.1 million in Licensing and Certification Program Fund for the Los Angeles County contract to account for several salary increases. DPH notes that Los Angeles County salaries are higher than state salaries and have increased in each of the past two years and will continue to increase in 2017 and 2018. Given these continuing cost pressures; DPH is evaluating the most effective way to provide ongoing regulatory oversight of health facilities in Los Angeles County.

Other Health and Human Services Issues

The budget also includes the following significant adjustments to augmentations included in the 2016 Budget Act.

Elimination of Health Care Workforce Augmentation – The budget reverts \$33.4 million General Fund in 2016-17 that was intended to support health care workforce initiatives at the Office of Statewide Health Planning and Development. The budget does not include additional funding in the future for this purpose.

Elimination of Community Infrastructure Grants – The budget reverts the one-time \$67.5 million General Fund augmentation included in the 2016 Budget Act for community infrastructure grants to cities and/or counties to promote public safety diversion programs and services by increasing the number of treatment facilities for mental health, substance use disorder, and trauma-related services.

Children's Mental Health Crisis Services Grants – The budget reverts \$17 million General Fund from 2016-17 intended for grants to local governments to increase the number of facilities providing mental health crisis services for children

and youth under the age of 21. \$11 million in Mental Health Services Act funding remains available for the program.

Eliminate Supplemental Funding for Three Independent Living Centers – The budget reflects a decrease of \$750,000 in 2017-18 to reflect the elimination of ongoing funding first included in the 2016 Budget Act to provide funding support for three independent living centers.

Human Services

Department of Developmental Services (DDS)

The Governor proposes an overall 2017-18 budget for DDS of \$6.9 billion (\$4.2 billion General Fund), a net increase of \$280 million (4.2 percent) over the updated current year budget.

DDS estimates the number of persons with developmental disabilities receiving services and supports in the community to be 317,000 and 490 individuals in state-operated developmental centers by the end of 2017-18.

Developmental Centers – The Governor's budget includes \$450 million (\$330 million General Fund) for the developmental centers, a decrease of \$80 million over the updated current year budget (or about 15 percent). Major proposals include:

- **Closure Activities** – The budget includes \$505,000 General Fund for closure-related activities.

Community Services Program – The budget includes about \$6.4 billion (\$3.8 billion General Fund) for services and supports provided or secured by regional centers, an increase of about \$359 million (or 5.9 percent) over the updated current year budget. Major proposals include:

- **Community Housing Projects** – The budget includes \$597,000 (\$544,000 General Fund) and four positions at DDS to provide increased oversight of community housing projects being developed to support persons moving out of state developmental centers.

- **Minimum Wage Increase** – The budget includes an increase of \$77.2 million (\$48 million General Fund) to reflect the impact of the increasing state minimum wage.

Department of Social Services – The budget includes \$23.6 billion (\$8.1 billion General Fund), a decrease of \$400 million General Fund over the current year.

- **California Work Opportunity and Responsibility to Kids (CalWORKs)** – The Governor proposes an overall 2017-18 budget of \$5.4 billion in federal, state, and local funds for the program and estimates a caseload of 459,000 families (a decrease of 5.6 percent).
 - **CalWORKs Grant Increases and the Repeal of the Maximum Family Grant (MFG) Rule** – Prior grant increases and the MFG repeal are estimated to cost \$405.3 million in 2016-17 and \$528.8 million in 2017-18. The Child Poverty and Family Supplemental Subaccount is projected to receive base and growth funds of \$318.8 million in 2016-17 and \$330 million in 2017-18, and these funds will be used to pay for the recent grant increases and the repeal of the MFG rule, which became effective January 1, 2017. The budget also includes \$86.5 million in General Fund in 2016-17 and \$198.2 million General Fund in 2017-18 to provide the remaining funding.
- **In-Home Supportive Services (IHSS)** – The budget includes \$10.6 billion (\$3.2 billion General Fund), a 6.5 percent increase over the current year, and estimates a 531,000 person caseload in 2017-18.
 - **Coordinated Care Initiative (CCI)** – The budget estimates that CCI will no longer be cost-effective and does not meet the statutory savings requirements. Therefore, the IHSS maintenance-of-effort provisions are repealed and the IHSS program returns to the prior state-county sharing ratios. Responsibility for collective bargaining also returns to counties. This change provides \$626.2 million General Fund savings in 2017-18.
- **Child Welfare Services: Continuum of Care Reform (CCR)** – The budget includes \$217.3 million (\$163.2 million General Fund) for the department, county child welfare agencies, and county probation departments to continue implementation of CCR reforms.

- **Child Welfare Digital Services** – The budget includes \$175.9 million (\$88 million General Fund) to support an increase in project activity, including funding for counties.
- **SSI/SSP** – The estimated caseload for the Supplemental Security Income/State Supplementary Payment (SSI/SSP) program is 1.3 million recipients (44 percent aged; one percent persons who are visually impaired or blind; 55 percent persons with disabilities). Effective January 2017, maximum SSI/SSP grant levels are \$895.72 per month for individuals and \$1,510.14 per month for couples. The Governor's budget includes \$2.9 billion General Fund for the SSI/SSP program.

The budget includes an estimated growth factor of 0.3 percent in 2017 and 2.6 percent in 2018 for the SSI (federal) portion of the grants. The budget also assumes a corresponding increase in costs for benefits under the state-only Cash Assistance for Immigrants (CAPI) program.

- **Housing and Disability Advocacy Program** – The budget includes one-time savings of \$45 million General Fund in the current year from halting implementation of the Housing and Disability Advocacy Program, which was included in the 2016 Budget Act to incentivize local governments to boost outreach efforts and advocacy to get more eligible people enrolled in the SSI/SSP program.

General Government and Local Government

The budget includes several proposals related to statewide issues and across departmental functions.

Department of Technology – The Department of Technology, the state's central information technology (IT) organization, approves and oversees statewide IT projects, statewide IT professional development, and centralized IT services to state and local governments. Within the department, the Office of Information Security (OIS) protects state information security policies and standards and provides technology direction to agencies to ensure the confidentiality, integrity, and availability of state systems and applications. The budget includes \$9.9 million (\$5.3 million General Fund) to strengthen information technology security operations across various departments.

Cannabis Regulation – In June 2015, Governor Brown signed the Medical Marijuana Regulation and Safety Act, which established the oversight and regulatory framework for the cultivation, manufacture, transportation, storage, and distribution of medical marijuana in California. Proposition 64, or the Adult Use of Marijuana Act, made the recreational use of cannabis by people over the age of 21 legal. The sale and distribution of cannabis as a regulated business was made legal by Proposition 64, beginning January 1, 2018. The General Fund provided loans to the Marijuana Control Fund to cover initial implementation and regulatory costs, since license fees will not be collected until January 1, 2018.

The budget includes \$52.2 million to fund regulatory activities, license processing, and enforcement. The budget includes several proposals across different departments, including:

- **Department of Food and Agriculture (CDFA)** – The budget proposes \$23.4 million to provide administrative oversight for the Cannabis Cultivation Program, establish regulations, issue cannabis cultivation licenses, and perform an environmental impact report. Also, the CDFA, with the California Department of Technology and the Board of Equalization, will establish a track and trace program to report the movement of products throughout the distribution chain.
- **Department of Consumer Affairs** – The budget includes \$22.5 million to augment the Bureau of Medical Cannabis Regulation within the Department of Consumer Affairs.
- **Department of Public Health** – For licensing and regulation of medical cannabis product manufacturers, the budget includes \$1 million.
- **Board of Equalization** – The budget includes \$5.3 million to notify businesses of new tax requirements and to update information technology systems. The Board of Equalization is required to administer an excise tax on cannabis sales and a cultivation tax on harvested cannabis that enters the commercial market.
- **Department of Health Care Services** – For establishing and implementing the public information program that will cover health-related topics pertaining to cannabis, the budget includes \$5 million in 2016-17.

Funding for Affordable Housing – The budget includes roughly \$3.2 billion in state and federal funding for grants and loans to construct affordable housing, assist first time homebuyers, and support homelessness programs. This includes \$480 million in funding for a variety of programs at the Department of Housing and Community Development and \$1.3 billion for the California Housing Finance Agency to provide loans to first time homebuyers. The budget also projects \$355 million in General Fund costs to pay debt service costs on housing bonds sold over the past decade.

Local Update of Census Address Program – The budget proposes \$7 million in General Fund resources to provide grants to encourage cities and counties to assist in their voluntary participation in efforts to increase the accuracy of the Census Bureau's Master List of addresses.

Strategic Growth Council – The budget proposes \$142 million for the Transformational Climate Communities Program, as well as technical assistance and outreach to support local climate actions in the state's top five percent of disadvantaged communities. Funding is for projects that integrate multiple, cross-cutting approaches to reduce greenhouse gas (GHG) emissions and may include investments in energy, transportation, active transportation, housing, urban greening, land use, water use efficiency, waste reduction, and other areas.

Employee Compensation and Retiree Health Unfunded Liability - The budget includes \$1.2 billion (\$602 million General Fund) for employee compensation, health care costs for active state employees, and retiree health care prefunding for active employees. Included in these costs are salaries and benefit increases as a result of contract negotiations and pay increases related to minimum wage changes. Funding is also included for 2018 calendar year increase in health care premiums and enrollment.

Employee Retirement – The budget estimates approximately \$5.3 billion (\$2.8 billion in General Fund) in total funding for state employee pensions. The budget also includes \$672 million General Fund for California State University retirement costs. These estimates include the effect of the recent CalPERS board decision to reduce the discount rate to seven percent over the next three budget years.

The budget also includes \$2.8 billion General Fund for state contributions to CalSTRS. This estimate assumes CalSTRS will adopt new mortality assumptions, implement a discount rate reduction, and exercise its authority to increase state

contributions by 0.5 percent, resulting in an additional \$153 million General Fund contributions.

Secure Choice Retirement Savings Program – The budget provides an initial \$15 million General Fund loan to fund the necessary start-up and administrative costs of the Secure Choice Retirement Savings Program; as described in Senate Bill 1234 (de León) Chapter 804, Statutes of 2016.

State's Civil Service System – The budget continues to implement and propose reforms to the state's civil service system. The budget includes \$2.8 million in reimbursement authority for the Department of Human Resources to expand the capacity of the statewide training center, providing additional streamlined and tailored instruction for civil service employees. The budget also establishes a statutory framework to further ongoing class consolidation efforts, as well as provide departments and job candidates with hiring flexibility and updating eligible lists more frequently.

Department of Industrial Relations – The budget provides \$4.6 million (Labor Enforcement and Compliance Fund), increasing to \$11.4 million by 2020-21, to implement strategic enforcement efforts to combat labor law violations, such as wage theft, in industries with the greatest needs for rigorous enforcement, such as the janitorial, garment manufacturing, and construction.

The budget also provides \$877,000 federal funds in 2016-17, and \$923,000 federal funds in 2017-18 to expand existing apprenticeship programs and create new programs for non-traditional fields with unmet labor demands. The department intends to enroll 6,000 more people in apprenticeship programs.

Redevelopment Agencies - The elimination of redevelopment agencies returned property tax money to local governments to invest in public services. The budget estimates that cities will receive \$733 million in general purpose revenues in 2016-17 and 2017-18, with counties receiving \$869 million, and special districts receiving \$260 million.

California Department of Corrections and Rehabilitation

The budget proposes total funding of \$11.3 billion (\$11 billion General Fund and \$307 million other funds) for the California Department of Corrections and Rehabilitation (CDCR) in 2017-18. This is an increase of approximately \$264 million General Fund over 2015-16 expenditures.

Adult Institution Population – The adult inmate average daily population is projected to decline from 129,015 in 2016-17 to 128,159 in 2017-18, a decrease of 856 inmates. This constitutes a decrease from the 2016 Budget Act's 2016-17 projection.

Parolee Population – The average daily parolee population is projected to increase from 43,686 in 2016-17 to 44,761 in 2017-18, an increase of 1,075 parolees. This is an increase from the 2016 Budget Act projections.

Division of Juvenile Justice (DJJ) Population – The DJJ's average daily ward population is decreasing slightly, when compared to 2016 Budget Act projections. Specifically, the ward population is projected to decrease by four in 2016-17, for a total population of 705; and projected to increase by 70 in 2017-18, for a total population of 779.

Mental Health Program Caseload – The population of inmates requiring mental health treatment is projected to be 36,283 in 2016-17 and 36,571 in 2016-17. This is an increase of 320 and 608, respectively, over the 2016 Budget Act projections.

Inpatient Psychiatric Programs – The Department of State Hospitals (DSH) currently operates 1,156 inpatient mental health treatment beds at three CDCR prisons. The budget proposes transferring these programs to CDCR, effective July 2017. In addition, the budget redirects \$250.4 million and 1,977.6 positions from DSH to CDCR.

Proposition 47 State Savings – The Administration estimates that the 2016-17 savings associated the Proposition 47, the Reduced Penalties for Some Crimes Initiative (2014) will be \$42.9 million in 2016-17, an increase of \$3.5 million in savings over 2015-16. On-going savings are estimated to be \$69 million.

Proposition 57 Implementation – The budget includes \$5.7 million General Fund for the workload associated with the implementation of Proposition 57, the Parole

for Non-Violent Criminals and Juvenile Court Trial Requirements Initiative (2016). In addition, the budget estimates a net savings of \$22.4 million General Fund in 2017-18, growing to a net savings of approximately \$140 million by 2020-21. Among the changes included in Proposition 57 are the following:

- Creates a parole consideration process for non-violent offenders who have served the full term of their primary criminal offense.
- Authorizes CDCR to award credits earned for good behavior and rehabilitation and educational achievements.
- Requires judges to determine whether juveniles charged with certain crimes should be tried in juvenile or adult court.

Segregated Housing Unit Conversions – The *Ashker v. Brown* settlement, related to the conditions of long-term confinement at Pelican Bay State Prison, has resulted in a reduction in the need for segregated housing by 992 beds at both Pelican Bay and Corcoran State Prison. The budget proposes converting those beds at Pelican Bay to level II housing and the beds at Corcoran to level IV housing.

Video Surveillance Pilot Program – The budget proposes \$11.7 million General Fund to implement a video surveillance pilot program at High Desert State Prison and the Central California Women's Facility.

Federal Receivership Overseeing Prison Medical Care – The budget proposes \$2 billion (General Fund) for the receiver's office, which includes an increase of \$33.3 million General Fund for new initiatives.

California Health Care Facility Janitorial Services – The budget proposes \$13.8 million General Fund to increase janitorial services to spaces constructed through the Health Care Facility Improvement Program and Statewide Medication Distribution improvements.

Suicide Watch – The budget proposes \$3.1 million General Fund for certified nursing assistants to provide one-on-one surveillance of inmates on suicide watch.

Registered Nurses – The budget proposes \$5.4 million General Fund for registered nurses to triage and remedy medical appeals.

Medication Distribution – The budget proposes \$8.9 million for additional licensed vocational nurses to distribute medication.

Property Controller Positions – The budget proposes \$2.1 million to create property controller positions to oversee all health care assets at the state prisons.

Local Public Safety

Post Release Community Supervision – The budget proposes \$11 million General Fund for county probation departments to supervise the temporary increase in offenders on post release community supervision as a result of the implementation of court-ordered measures and Proposition 57.

Community Performance Incentive Grant – The budget assumes \$114.9 million General Fund for county probation departments to support the continued efforts of counties to reduce the number of offenders sent to prison.

Elimination of Community Infrastructure Grants – The budget reverts the one-time \$67.5 million General Fund augmentation included in the 2016 Budget Act for community infrastructure grants to cities and/or counties to promote public safety diversion programs and services by increasing the number of treatment facilities for mental health, substance use disorder, and trauma-related services.

Fines, Fees and Assessments

State Penalty Fund – The budget proposes to reduce the number of programs supported by the State Penalty Fund due to a significant decrease in revenue over recent years. Specifically, the budget proposes the elimination of the following:

- The Motorcyclist Safety Program – California Highway Patrol
- Local Public Prosecutors and Public Defenders Training Program – Office of Emergency Services
- Internet Crimes Against Children Task Forces – Office of Emergency Services
- California Gang Reduction, Intervention and Prevention Program – Board of State and Community Corrections

Repeal of Driver's License Suspension – The budget proposes eliminating a court's authority to suspend driver's licenses as an incentive for individuals to pay fines and penalties due to the court.

Department of State Hospitals

The budget proposes total funding of \$1.6 billion (\$1.4 billion General Fund) for the Department of State Hospitals (DSH) in 2017-18. DSH is comprised of five state hospitals and three psychiatric programs. (As previously noted, the budget proposes shifting the three psychiatric programs to CDCR in 2017-18.) The Administration estimates that the population served by the five state hospitals will reach a total of 6,369 in 2017-18.

Incompetent to Stand Trial Caseload – The budget proposes \$10.8 million General Fund to establish a 60-bed Admission, Evaluation, and Stabilization Center for the assessment and treatment people who have been deemed Incompetent to Stand Trial.

Judicial Branch

The budget proposes 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.

Trial Court Judge Reallocation – The budget proposes to reallocate four vacant superior court judgeships to areas of the state where workload is the highest.

Employee Benefit Costs – The budget proposes \$7.1 million General Fund for increases in trial court employee benefit costs.

Judicial Officer Salaries – Judicial officer salaries are tied to the salary increases of other state workers. The budget proposes amending current law so that judicial officers receive the proportional equivalent of the salary increases that have provided retroactively to July 1 to state workers.

Trial Court Trust Fund Backfill – The budget proposes \$55 million General Fund to backfill reductions in fine and penalty revenue in 2017-18.

Case Management System Replacement – The budget proposes \$5 million General Fund (\$4.1 million in 2017-18 and \$896,000 in 2018-19) as one-time

funding to replace the Sustain Justice Edition Case Management System in nine small superior courts.

Department of Justice

The budget proposes total funding of \$825 million (\$222 million General Fund) for the Department of Justice in 2016-17, growing to \$858 million (\$215 million General Fund) in 2017-18. The proposed 2017-18 budget represents an increase of \$119 million over 2015-16 expenditures. In addition, the budget proposes an increase of 31 positions in 2017-18.

Assault Weapon Registration – The budget proposes an increase of \$2,588,000 and 27 positions in 2017-18 in Dealers' Record of Sale (DROS) Special Fund spending authority to implement the provisions of Senate Bill 880 (Hall), Chapter 48, Statutes of 2016, and Assembly Bill 1135 (Levine), Chapter 40, Statutes of 2016. Both bills change the definition of an assault weapon. Both bills close the bullet button loop-hole by defining an assault weapon as any semiautomatic weapon that does not have a fixed magazine. In addition, the bills require the registration of semiautomatic weapons that were not previously prohibited prior to the passage of this legislation.

The requested funding would be loaned from the Firearms Safety and Enforcement (FS&E) Special Fund, and would be repaid no later than June 30, 2021, by revenue in the DROS fund.

Firearm Identification – The budget proposes an increase of \$1,368,000 in 2017-18, \$1,022,000 in 2018-19, \$866,000 in FY 2019-20 and \$820,000 on-going in Dealers' Record of Sale (DROS) Special Fund spending authority to support eight positions to implement the provisions of AB 857 (Cooper), Chapter 60, Statutes of 2016. AB 857 requires a person, commencing July 1, 2018, to apply to and obtain from the Department of Justice (DOJ) a unique serial number or other mark of identification prior to manufacturing or assembling a firearm; and requires by January 1, 2019, any person who, as of July 1, 2018, owns a firearm that does not bear a serial number assigned to it to obtain a unique serial number or other mark of identification.

The requested funding would be loaned from the Firearms Safety and Enforcement (FS&E) Special Fund, and would be repaid no later than June 30, 2021, by revenue in the DROS fund.