CALIFORNIA Senate Republican Caucus

Highlights and Analysis of the Governor's 2015-16 Budget

January 14, 2015
SENATE REPUBLICAN FISCAL OFFICE

Table of Contents

Budget Briefs

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Executive Summary

Despite being precariously balanced, there are many positive elements in the Governor's budget plan. It builds the rainy day reserve to $2.8 billion (*see Proposition 2 Rainy Day Fund Page* 6), pays off about $4 billion of past budgetary debts (*see State Debts and Liabilities Page 52),* increases funding for K-14 education programs, and calls for a tuition freeze at California state colleges and universities (*see Education Page 13*). Republicans are very supportive of these policies.

The Governor's 2015-16 budget proposes a **new record high spending level of over $265 billion** ($113.3 billion General Fund, $45.5 billion Special Funds, $5.9 billion Bond Funds, and $100.4 billion Federal Funds). This exceeds the 2014 Budget Act total spending ($254 billion) by nearly $11 billion. State General Fund spending accounts for about half of the increase, growing by $5 billion from $108 billion last year to over $113 billion for 2015-16.

Looking at state spending another way, the budget proposes to spend more than $8 for every $100 of Californian's personal income or **nearly $4,240 per person**. As is well known, California's highly volatile tax structure ensures that those who pay to fill the treasury are generally not the ones consuming the services. The top one percent of taxpayers paid over 50 percent of the personal income taxes while more than 40 percent of tax filers did not pay any income taxes (*see Appendix A – California's Tax Rankings Page 54*).

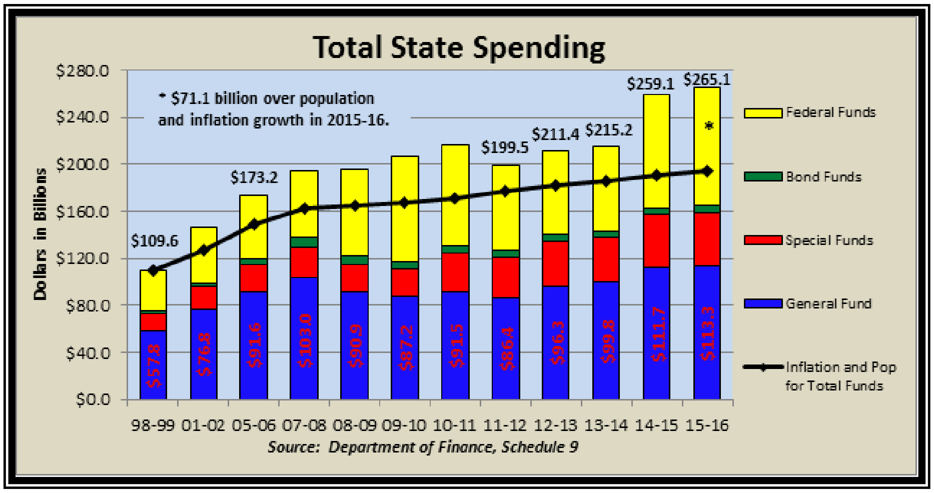
Notably **Health and Human Services program spending accounts for more than half the budget** at $142 billion (Medi-Cal represents $95 billion of that amount), while total education spending for both K-14 and Higher Education programs is only $80 billion (including Proposition 98 local property tax expenditures). Despite California's very generous social safety net (*see Appendix B – California Safety Net Facts Page 60*), poverty continues to be a pressing issue largely because of the exorbitant high cost of living that is driven by high housing and energy costs. Any attempt to tackle California's growing poverty rates should focus on the core causes, such as state and local policies that can increase housing costs by 15 to 30 percent and regulations that make life's basic needs more expensive for working families. Acting as if increased welfare checks are the solution to California's poverty problem is nonsensical. History has shown that the current welfare system yielded poor results. As Governor Brown noted, "California does more than most states to mitigate that (poverty)…We do have quite a safety net."

While the state budget appears to be balanced in the near term, the Department of Finance projects that even under current policies, **California will return to operating deficits in excess of $1 billion by 2018-19**. In addition, with hundreds of billions of dollars in unfunded liabilities and other debts for public employee pensions, retiree health care, and infrastructure, the term "balanced budget" is somewhat deceptive.

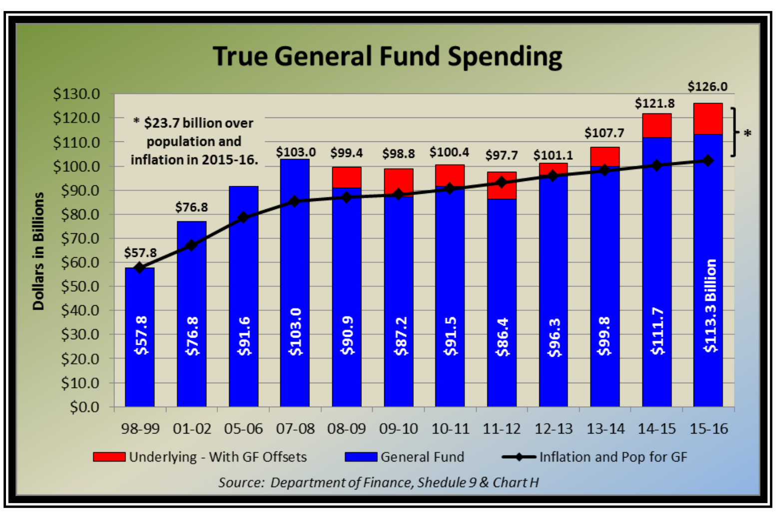
The bottom line is that, despite the Governor's call for fiscal responsibility, California is already on a path to fiscal instability. **Legislative Democrats' demands to further increase government spending by billions of dollars poses a serious threat to our state's future**.

Essential Charts

Total State Spending Sets New Record. General Fund spending is only a part of total state spending. Special fund, bond fund, and federal fund expenditures bring total state spending for 2015-16 to about $265.1 billion. Despite the Great Recession, and Democrats' claims of "cutting to the bone," total state spending again reaches new record highs in 2015-16. Total expenditures per $100 of personal income are $8.13 or **$4,240 for every Californian**.

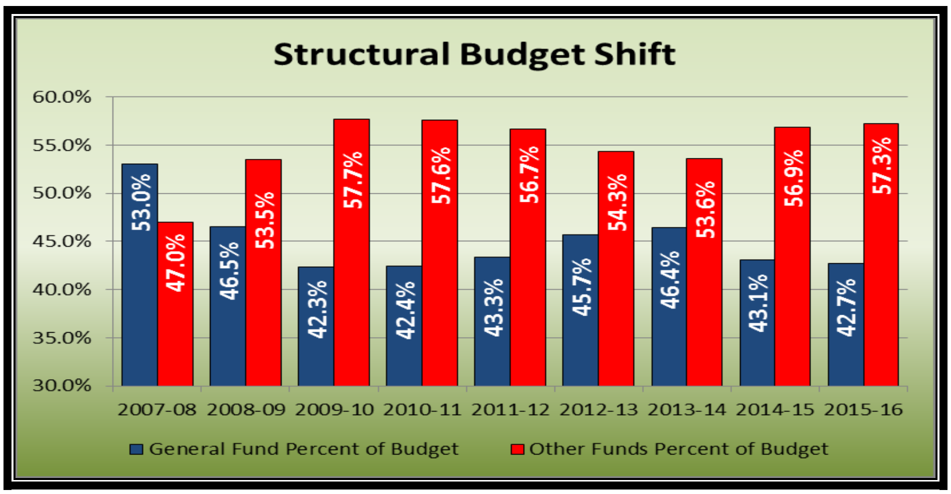


True General Fund Program Spending. Over the past several years, legislative Democrats frequently claimed that state spending had been slashed by $40 billion or more, and General Fund spending was consistently below its historic peak of $103 billion in 2007-08. In fact, true General Fund program spending, which includes fund shifts, transfers, and various General Fund offsets, remained no more than five percent less than 2007-08 spending. *As shown on the chart below*, now that General Fund revenues have rebounded, actual General Fund spending has increased to $113.3 billion in 2015-16 ($10.3 billion more than 2007-08), and **true General Fund program spending has increased to $126 billion in 2015-16, which is $23 billion higher than it was before the great recession.**

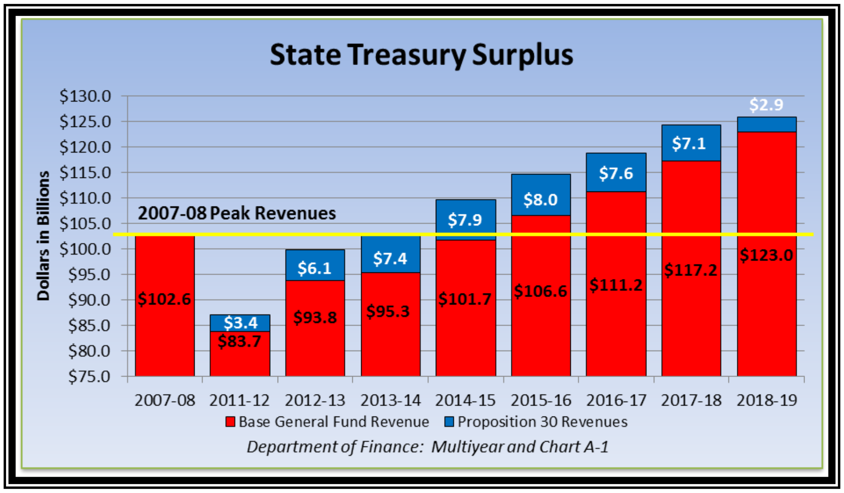


The 2015-16 Governor's Budget includes $12.7 billion of spending from fund sources other than the General Fund to support General Fund programs, including the $7.2 billion "Realignment," $2.1 billion of Medi-Cal related special taxes and cost shifts, $1 billion from the dissolution of redevelopment agencies, and $1.2 billion from transportation weight fees to fund debt service.

Spending From Other Funds Dominates Budget with Little Attention. Prior to the recent budget crisis the General Fund was the predominant fund for financing state government programs. However, *as the chart below demonstrates*, other funds (federal, special, and bond funds) have now become the primary sources for state spending. Prior to the most recent budget crisis 53 percent of state spending came from the General Fund, but now it is less than 43 percent. **The new practice has allowed legislative Democrats and others to claim state spending has been slashed when in fact it has grown dramatically because it masks the true effects of General Fund program reductions**. Furthermore, since the Legislature, the press, and the public tend to focus on the General Fund, the growth in other fund spending has occurred with scant oversight or attention. It is a sly way to grow spending while appearing fiscally austere and responsible. Senate Republicans plan to shed more light on this practice.



The State Treasury Surplus - Proposition 30 Tax Increases Not Needed. Based on Department of Finance projections, even without the tax increases from Proposition 30 (2012), fiscal year 2015-16 baseline state General Fund revenues ($106.6 billion) will eclipse the last tax revenue windfall prior to the Great Recession ($102.6 billion in 2007-08) by $4 billion. Once the Proposition 30 tax increases ($8 billion) are added on top of these baseline taxes, 2015-16 General Fund revenues will exceed 2007-08 levels by $12 billion. As demonstrated in *the chart on the next page*, it is clear that the Proposition 30 taxes are not necessary to balance the state budget. In fact, those **tax increases are simply providing a new windfall for the state treasury at the expense of hard working California families**. By 2018-19 base General Fund revenues are projected to reach $123 billion, which is $20 billion more than the pre-recession peak. **Despite the surplus revenue currently filling state coffers, many leading Democrat lawmakers and their interest groups are scheming to make the Proposition 30 tax increases permanent.**



Proposition 30 Promises to Students Not Kept. In 2012, California voters signaled their willingness to prioritize education when they agreed via Proposition 30 to pay higher taxes to benefit education. However, actual K-14 Proposition 98 funding in 2015-16 will include only about 52 percent ($4.2 billion) of the more than $8 billion in tax revenue generated by Proposition 30 - *education will not get the full benefit of those tax hikes, as voters were led to believe.* As shown in the chart below, if Proposition 30 revenues were dedicated solely to K-14 education, funding for the state's schools and community colleges would be over $3.8 billion higher in 2015-16 than provided in the Governor's proposed budget.

Budget uses Prop 30 revenue for non-education programs

$ in billions

	2015-16
Minimum Prop 98 guarantee with no Prop 30 revenue [1/]	**$61.544**
Proposition 30 revenue	**$8.018**
Minimum Prop 98 guarantee plus all Prop 30 revenue	**$69.562**
Prop 98 funding included in 2014-15 budget	**$65.716**
Prop 30 revenue used for non-education programs	**$3.846**

[1/] per Legislative Analyst

Instead of targeting all of the Proposition 30 revenue toward education, the Governor's Budget uses much of it for other priorities: increased pension contributions and salary and benefit increases for state employees ($900 million), increased health and human services program spending ($1.4 billion), higher corrections spending ($165 million), and rainy day reserves ($1.2 billion). *The promise of Proposition 30 continues to be broken (see Proposition 30 Promises Not Kept on Page 12).*

Proposition 2 Rainy Day Fund

In November 2014, California voters overwhelmingly approved Proposition 2 to establish meaningful Rainy Day Fund (RDF) requirements in the state constitution. The Governor's budget demonstrates that Proposition 2 is already benefitting California taxpayers by billions of dollars. Common sense allocations of funds to the RDF and debt repayment help ensure that taxpayers and key programs like public schools are protected from California's boom-and-bust revenue cycles, rather than being subject to the whims of spendthrift legislative Democrats.

Billions in Reserves Projected. As summarized in the table below, the Governor's 2015-16 budget proposes a rainy day transfer of $1.2 billion for the general RDF and another $1.2 billion for debt reduction. Over four years these annual transfers are projected to reach $9.0 billion, including nearly $4.5 billion each for RDF deposits and debt reduction. Notably, $7.3 billion of these combined amounts results from the up-front 1.5 percent set-aside that Republicans negotiated in the development of Proposition 2. The annual deposits are projected to create a RDF balance of nearly $6.1 billion by the end of 2018-19.

Rainy Day Fund Forecast

Dollars in Millions

	2015-16	2016-17	2017-18	2018-19	Total
Annual 1.5% of General Fund Revenues	$1,719	$1,782	$1,864	$1,888	$7,253
Capital Gains Taxes in Excess of 8% of General Fund Revenues	$721	$378	$404	$202	$1,705
Rainy Day Amounts Available	**$2,440**	**$2,160**	**$2,268**	**$2,090**	**$8,958**
Debt Repayment (50%)	$1,220	$1,080	$1,134	$1,045	$4,479
Deposit to Rainy Day Fund (50%)	$1,220	$1,080	$1,134	$1,045	$4,479
Rainy Day Fund Balance at End of Year [1]	**$2,826**	**$3,906**	**$5,040**	**$6,085**	

1. Includes beginning balance from 2014-15 of $1.6 billion.

Note: Capital gains amounts are net of revenues attributable to Proposition 98. All estimates assume there are no budget shortfalls that would allow other uses of Rainy Day amounts to maintain spending.

Source: Department of Finance, January 2015

Risk of Manipulation. Senate Republicans agree that the Governor's budget proposal for building the RDF and paying down debt meets the requirements of Proposition 2 and enacts the will of California voters. The Governor's proposal also appears consistent with the approach used by the Legislative Analyst's Office in its November 2014 Fiscal Outlook. **Nonetheless, there is real risk that legislative Democrats may seek ways to undermine voter intent and find some rationale to raid the RDF to increase spending.** Already the Governor's budget forecasts that current policies will return the state to an operating deficit of more than $1.1 billion by 2018-19, demonstrating the need for continued fiscal restraint. Senate Republicans will be vigilant in ensuring that the final budget reflects voters' intentions that the state keep saving for the inevitable next fiscal crisis.

Expenditures

The 2015-16 Governor's Budget includes revised General Fund expenditures of $111.7 billion in 2014-15 and projected General Fund expenditures of $113.3 billion in 2015-16. As shown in the table below, since the 2014 Budget Act was signed, spending in the current year has increased by more than $3.7 billion, and the Governor has proposed to spend an additional $5.3 billion in 2015-16 (above the 2014 Budget Act spending level). As a result, while the following table reflects a year-over-year spending increase of $5.3 billion, the true spending increase is $9 billion over the 2014 Budget Act.

General Fund Expenditures by Agency

(Dollars in Millions)

Agency	Budget Act 2014-15	Revised 2014-15	Governor's Budget 2015-16	Year over Year Change
Legislative, Judicial, Executive	$2,968	$3,007	$3,131	$163
Business, Consumer Services, Housing	$850	$839	$639	-$211
Transportation	$216	$158	$237	$21
Natural Resources	$2,260	$2,497	$2,561	$301
Environmental Protection	$63	$78	$68	$5
Health and Human Services	$29,652	$30,490	$31,929	$2,277
Corrections and Rehabilitation	$9,590	$9,995	$10,160	$570
K-12 Education	$44,980	$47,121	$47,173	$2,193
Higher Education	$12,562	$12,947	$14,063	$1,501
Labor and Workforce Development	$303	$282	$265	-$38
Government Operations	$692	$730	$701	$9
General Government/Other	$2,245	$1,969	$2,371	$126
Supplemental ERB Payment	$1,606	$1,606		-$1,606
Total, General Fund Expenditures	**$107,987**	**$111,719**	**$113,298**	**$5,311**
Accumulated spending increase since the Budget Act		$3,732	$5,311	**$9,043**
- As a Percentage		3.5%	4.9%	**8.4%**

Source: Department of Finance, Schedule 9

The "General Government/Other" category includes a variety of small departments, tax relief, and statewide proposals that have not yet been allocated to specific departments or programs, including employee compensation adjustments, health and dental benefits for annuitants, and the PERS deferral.

The largest General Fund expenditure growth would occur in Education (driven by Proposition 98 requirements and strong revenue growth) and Health and Human Services (driven by a variety of factors ranging from increased Medi-Cal costs to paying for IHSS overtime). Also note that Proposition 58 (2004) resulted in a one-time expenditure of $1.6 billion for a supplemental payment on the Economic Recovery Bonds in 2014-15.

General Fund spending is only a part of total state spending. ***As shown on Page 3 of the Executive Summary***, the expenditure of special funds, bond funds, and federal funds brings total state spending to $265.1 billion for 2015-16. This level of total state expenditures is $6.0 billion higher than revised total expenditures for 2014-15 ($259.1 billion). By comparison, total state spending proposed for 2015-16 ($265.1 billion) is about $70.8 billion higher than California's last economic peak year prior to the recession ($194.3 billion in 2007-08). Despite the Great Recession and Democrats' claims of “cutting to the bone,” **total state spending continues to break records each year.** Total expenditures per $100 of personal income ($8.13) are slightly lower than the historic 20-year average ($8.14), but higher than the historic 30-year average ($8.07).

True state General Fund program spending, which accounts for fund shifts, transfers, and General Fund offsets – allowing General Fund programs to continue growing – now totals $126 billion in 2015-16, which is **26.4 percent higher than peak General Fund spending in 2007-08.**

Underlying General Fund Program Spending

(dollars in billions)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Schedule 9 Expenditures	**$103.0**	**$90.9**	**$87.2**	**$91.5**	**$86.4**	**$96.3**	**$99.8**	**$111.7**	**$113.3**
"Offsets" to Maintain General Fund Program Levels*	--	$8.5	$11.6	$8.9	$11.3	$4.8	$7.9	$10.1	$12.7
Total, General Fund Program Expenditures	**$103.0**	**$99.4**	**$98.8**	**$100.4**	**$97.7**	**$101.1**	**$107.7**	**$121.8**	**$126.0**
Percentage Change from Peak 2007-08 General Fund Spending		-3.5%	-4.0%	-2.6%	-5.1%	-1.9%	4.6%	21.7%	26.4%

Department of Finance – Schedule 9

In addition to $113.3 billion General Fund, the 2015-16 Governor's Budget relies on (1) $1 billion of property taxes from the dissolution of redevelopment agencies to fund education, (2) realigning $7.2 billion of public safety and human services programs to the local level, (3) $1.2 billion of weight fees to pay general obligation transportation bond debt, and (4) nearly $2.1 billion of Medi-Cal related special taxes and cost shifts. In prior years, the Legislature relied on additional federal funds, money from redevelopment agencies, inter-year Proposition 98 deferrals, employee compensation deferrals, and local property tax borrowing to maintain General Fund programs in the absence of General Fund revenues.

Over the past six years, we have included this table to demonstrate that even though actual General Fund spending **had** decreased below 2007-08 spending levels, cost-shifting actions taken by the Legislature over those years to solve chronic budget deficits had the effect of retaining General Fund program spending near or above the 2007-08 pre-recession peak.

Now that General Fund revenues have rebounded and **actual General Fund expenditures are proposed to exceed 2007-08 spending levels by $10.3 billion** (10 percent higher), “Offsets to Maintain General Fund Program Levels” that were established to “save” General Fund programs remain intact. As a result, **underlying General Fund program spending has been driven far beyond previous peak General Fund spending levels.**

Revenues

The 2015-16 Governor's Budget continues to forecast strong revenue growth throughout the three-year forecast period (stronger than estimates provided by the Legislative Analyst's Office (LAO) in its' November 2014 *Fiscal Outlook)*. After accounting for the money being transferred to the Budget Stabilization Account per Proposition 2 of 2014 ($1.6 billion in 2014-15 and $1.2 billion in 2015-16), the Governor's budget estimates total General Fund revenues and transfers of $108 billion in 2014-15, increasing to $113.4 billion in 2015-16. This revised revenue estimate reflects total **General Fund revenues being up by almost $4.1 billion compared to forecasts prepared for the 2014 Budget Act last June. Notably, General Fund revenues for 2015-16 are about $11.2 billion higher than the pre-recession revenue peak of $102.6 billion in 2007-08.**

Total Revenues and Transfers	Budget Act	Governor's Budget	Forecast Change	%△
2013-14	$102,185	$102,675	$490	0.5%
2014-15	$105,489	**$108,042**	$2,553	2.4%
2015-16	$112,329	**$113,380**	$1,051	0.9%
Change to Estimate over 3-year Window			**$4,094**	

Source: Governor's Budget Summary

Personal Income Tax – The Department of Finance (Finance) estimates a $2.3 billion increase to the three-year forecast. According to Finance, stronger revenue estimates are being driven by higher capital gains forecasts resulting from robust growth in stock prices during the second half of 2014 and higher tax receipts from wages.

Personal Income Tax	Budget Act	Governor's Budget	Forecast Change	%△
2013-14	$66,522	$66,560	$38	0.1%
2014-15	$70,238	$71,699	$1,461	2.1%
2015-16	$74,444	$75,213	$769	1.0%
Change to Estimate over 3-year Window			**$2,268**	

Source: Governor's Budget Summary

Corporation Tax – Finance estimates that the current tax structure will generate an additional $2 billion of revenues from the corporate tax, which it indicates is due to a combination of increased corporate tax payments (up 14 percent in 2014) and lower refunds (down 10 percent in 2014).

Corporation Tax	Budget Act	Governor's Budget	Forecast Change	%△
2013-14	$8,107	$8,858	$751	9.3%
2014-15	$8,910	$9,618	$708	7.9%
2015-16	$9,644	$10,173	$529	5.5%
Change to Estimate over 3-year Window			**$1,988**	

Source: Governor's Budget Summary

Sales and Use Tax – Finance estimates that sales and use tax revenues will be lower by about $1.4 billion over the three-year budget window, due to the lower growth rate in sales and use tax receipts in 2014. Finance also indicates that sales and use tax revenue growth from 2013-14 to

2014-15 is muted due to a $486 million reduction to 2014-15 revenues resulting from the start of the manufacturing equipment sales tax exemption on July 1, 2014. This exemption excludes the first $200 million of manufacturing or biotech research and development equipment from the state sales tax rate.

Sales and Use Tax	Budget Act	Governor's Budget	Forecast Change	%△
2013-14	$22,759	$22,263	-$496	-2.2%
2014-15	$23,823	$23,438	-$385	-1.6%
2015-16	$25,686	$25,166	-$520	-2.0%
Change to Estimate over 3-year Window			**-$1,401**	

Source: Governor's Budget Summary

LAO Believes Governor's Revenues Too Conservative. According to the LAO, "…there is a strong possibility that revenues for 2014-15 will be significantly above the administration's new projections." The LAO indicates that the state's big three taxes are already $3.5 billion ahead of the 2014 Budget Act projections, but the Administration only raised its revenue estimates for the entire fiscal year by about $2.5 million. "Barring a sustained stock market drop, an additional 2014-15 revenue gain of $1 billion to $2 billion above the administration's new estimate seems likely. Even bigger gains of a few billion dollars more are possible." Republicans are concerned that legislative Democrats will ignore the LAO's caution to build the state budget reserve to prepare for the inevitable revenue downturn and will instead use these surplus revenues from hard working California families to expand non education spending programs. That's how they caused the last budget crisis.

Proposition 30. One of the main drivers of revenue growth over the past three years continues to be the passage of Proposition 30 by voters in November 2012. The tax increases included in Proposition 30 are temporary and completely expire by 2018-19. In May 2013, the Governor estimated that the total impact of Proposition 30 would generate about $44.5 billion of new revenue over the eight-year life of the tax increase. The following table on the next page reflects the most recent Department of Finance estimate of revenues related to Proposition 30 **(totaling $50.3 billion over the eight-year period**).

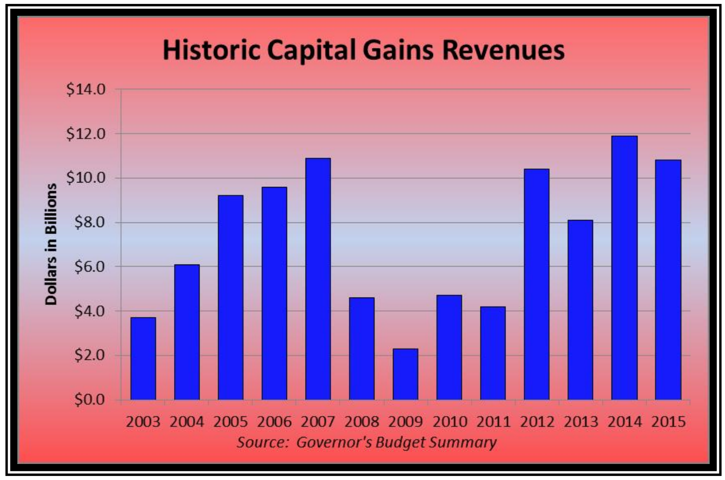
Proposition 30 Revenue Estimates
Dollars in Millions

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
PIT	$3,356	$5,417	$6,025	$6,458	$6,489	$6,765	$7,132	$2,912
SUT		$640	$1,371	$1,409	$1,529	$804	$0	$0
Total	**$3,356**	**$6,058**	**$7,396**	**$7,867**	**$8,018**	**$7,569**	**$7,132**	**$2,912**

Source: Department of Finance

As discussed on Page 13 (*Proposition 30 Promises Not Kept*), California voters were promised that Proposition 30 tax increases were necessary to mitigate and avoid spending cuts to the state's education programs. Even though base revenues are much stronger than anticipated in 2011-12 and the increased taxes are not necessary to protect education spending, some leading Democrats still want to make the tax increases permanent to support other new spending. Pursuant to Proposition 26 (2010), extending Proposition 30 tax increases beyond their current expiration dates or making them permanent would require a 2/3 vote of the Legislature.

Volatility. One positive aspect of the Governor's budget is that it recognizes the volatility of capital gains and incorporates a decision made by the voters this past November to establish a rainy day reserve to combat this volatility (*see Proposition 2 Rainy Day Fund section on Page 6*). Since capital gains in California are taxed at the marginal personal income tax rate of the individual taxpayer, and are generally associated with higher income earners, fluctuations in the stock markets and real estate markets tend to translate into additional volatility in personal income tax revenues.



The adjacent chart demonstrates the large swings in capital gains tax revenues over the past 14 years.

Per Capita Tax Collections. California is one of the highest taxing states in the country. As discussed in Appendix A-California's Tax Rankings, Page 44, California has the highest personal income taxes, highest state sales tax rate, highest corporate taxes in the western United States, and second highest gas taxes in the country. This all translates into California taxpayers paying more and more each year to support state government operations. According to the 2015-16 Governor's Budget Summary, California will collect $3,634 from each and every individual in the state. This, of course, is a record high for the state, and is about $600 higher than the state collected in 2007 (during the last economic peak prior to the Great Recession). **Notably, this does not include any taxes collected by local governments or the federal government.**

Proposition 30 Promises Not Kept

Proposition 30 spending on education. According to the Proposition 30 ballot summary, its tax hikes were expected to generate additional state revenues of about $6 billion annually from 2012-13 through 2016-17, and smaller amounts in 2017-18 and 2018-19. The summary also stated that these additional revenues would be "available to fund programs in the state budget." However, in a very calculated effort, the Governor and others who campaigned for the initiative led voters to believe that *all* of the Proposition 30 tax increase revenue would be used for education. Then, after voters agreed to the new taxes, he and legislative Democrats proceeded to negotiate budgets that used much of that revenue for other priorities (e.g., the Governor's 2015-16 proposal spends $900 million for increased state employee salaries and benefits and $1.4 billion for Health and Human Services programs such as expanded Medi-Cal, welfare grant increases, cash grants for drug felons, and In Home Supportive Services overtime pay). As the chart below shows, the proposed budget continues to divert over $3.8 billion (about half) of projected 2015-16 Proposition 30 revenue to non-K-14 education programs:

Budget uses Prop 30 revenue for non-education programs
$ in billions

	2015-16
Minimum Prop 98 guarantee with no Prop 30 revenue [1/]	**$61.544**
Proposition 30 revenue	**$8.018**
Minimum Prop 98 guarantee plus all Prop 30 revenue	**$69.562**
Prop 98 funding included in 2014-15 budget	**$65.716**
Prop 30 revenue used for non-education programs	**$3.846**

[1/] per Legislative Analyst

Specifically:

- According to the Legislative Analyst, in the absence of Proposition 30 revenue, the Proposition 98 minimum guarantee of funding for K-14 education would be about $61.5 billion.
- Estimated revenue from Proposition 30 in 2015-16 is just over $8 billion.
- Thus, despite multi-billion dollar growth in Proposition 98 funding, it is still over $3.8 billion below what it would be if all Proposition 30 revenue was spent on K-14 education, as promoted by its supporters. Even taking into account base augmentations totaling about $500 million each for the University of California and California State University, K-14 and higher education programs together will get only about 60 percent of the 2015-16 Proposition 30 revenue.
- The Administration says that all Proposition 30 revenue goes into a special account used entirely to fund K-14 education, which is true. However, what it fails to acknowledge is that these special funds offset state General Fund that would have to be spent to meet the Proposition 98 guarantee *even if Proposition 30 revenue did not exist,* thereby freeing up that same amount of General Fund for non-education uses.

Education

Proposition 98 funding rises substantially. The chart below displays proposed 2015-16 Proposition 98 funding for K-14 education, based on the Governor's revenue estimates.

Proposition 98 Funding at 2015-16 Governor's Budget

Source: Legislative Analyst's Office

($ in millions)

	2013-14 at 14-15 FBA[2]	2013-14 at 15-16 GB[3] (revised)	change from FBA to GB	2014-15 at 14-15 FBA	2014-15 GB at 15-16 GB (revised)	change from FBA to GB	2015-16 GB	change from revised 14-15
K-12 education [1/]								
General Fund	$38,465	$38,512	$47	$40,092	$41,987	$1,895	$41,937	-$50
Local property tax revenue	$13,405	$13,671	$266	$14,089	$14,184	$95	$16,068	$1,884
K-12 subtotal	$51,870	$52,183	$313	$54,181	$56,171	$1,990	$58,005	$1,834
California Community Colleges [4/]								
General Fund	$4,187	$4,235	$48	$4,293	$4,581	$288	5,002	421
Local property tax revenue	$2,167	$2,178	$11	$2,308	$2,321	$13	2,628	307
CCC subtotal	$6,354	$6,412	$58	$6,601	$6,902	$301	$7,630	$728
Other Agencies	$78	$78	$0	$77	$80	$3	$80	$0
Total Proposition 98	$58,302	$58,673	$371	$60,859	$63,153	$2,294	$65,716	$2,563
General Fund	$42,730	$42,824	$94	$44,462	$46,648	$2,186	$47,019	$371
Local property tax revenue	$15,572	$15,849	$277	$16,397	$16,505	$108	$18,697	$2,192

[1/] K-12 education includes state preschool, which is funded with Prop 98

[2/] FBA = final budget act

[3/] GB = Governor's budget

[4/] 2015-16 CCC display includes $500m for adult ed which can flow to any K-14 provider (not restricted to CCCs)

As the chart shows, Proposition 98 spending rises substantially from the amounts assumed in the 2014-15 Budget Act, from $58.3 billion to $58.7 billion in 2013-14 (up $371 million); from $60.9 billion to $63.2 billion in 2014-15 (up $2.3 billion), and to $65.7 billion in 2015-16, up almost $2.6 billion from the higher current-year level, a new all-time high.[1] This funding surge is partially attributable to the "maintenance factor" obligation payments imposed by Proposition 98, which will eventually return K-14 spending to the level it would have been had no funding reductions occurred during the recent economic downturn. By the end of 2015-16, the maintenance factor obligation is expected to stand at about $1.9 billion.

Wall of debt falls: deferrals eliminated, mandates backlog reduced. The Governor proposes to use the increase in 2014-15 Proposition 98 funding to fully extinguish inter-year funding deferrals to schools and community colleges, which at their high point in 2011-12 exceeded $10.4 billion. In addition, he provides $975 million in 2014-15 ($829 million for K-12 schools and $146 million for community colleges) and another $218 million in 2015-16 ($65 million for K-12 schools and $153 million for community colleges) to reduce the backlog of unpaid K-14 education mandate claims to about $4 billion. Republicans are supportive of these efforts based on a belief that the state's wall of debt should be fully eliminated before existing programs are expanded or new programs launched.

[1] As a point of fiscal reference, Proposition 98 spending in 2007-08, the last "good year" before the start of the recession, was $56.6 billion. Proposed 2015-16 funding has now grown from that level by over $9.1 billion.

Local Control Funding Formula grows toward targets. The state's new local control funding formula (LCFF) for K-12 schools will enter its third year of implementation in 2015-16. Under the formula, local educational agencies (LEAs) receive per-pupil base grants based on average daily attendance, according to grade span (K-3, 4-6, 7-8, and 9-12), with base rates enhanced for grades K-3 (by 10.4 percent) and grades 9-12 (by 2.6 percent). In addition, they get supplemental grants worth an additional 20 percent of base grant funding for each low-income student,[2] English learner, or foster youth,[3] and concentration grants worth an additional 50 percent of base funding for these same students, to the extent that they exceed 55 percent of an LEA's total enrollment. The Governor's 2015-16 budget provides an augmentation of just over $4 billion to bring locally-controlled LCFF funding to $50.7 billion. Roughly $10 billion more will be needed to eventually reach target funding levels. Republicans have supported additional LCFF funding based on its enhancement of local control and a belief that education should be one of the state's highest budget priorities.

New career technical education transition (CTE) grants. In an effort to ensure that CTE programs continue after an existing two-year maintenance of effort (MOE) requirement ends in June 2015, the Governor's 2015-16 budget proposes a new transitional CTE incentive grant program funded at $250 million each year for three years. The grants would require a 1:1 state/local funding match, and priority would be given to regional partnerships. Recipients would be required to demonstrate positive outcomes and would have to agree to continue the programs after state funds expire. This program is part of a larger workforce proposal which includes Adult Education, Apprenticeship, and Workforce Investment Act funds. Further details are expected when the Governor releases his education trailer bill language in February 2015. It will be important to monitor the extent to which local educational agencies continue to offer CTE programs after the incentive grants expire at the end of 2017-18.

Adult education expanded. Similarly, in recognition of the pending expiration of a two-year MOE requirement for adult education at the end of June 2015, the Governor's budget proposes $500 million for a block grant to expand adult education through regional consortia of K-12 schools and community colleges. First call on the funds would be to backfill local expenditures currently required by the MOE, estimated to be between $300 and $350 million. Remaining funds would be allocated by regional committees in accordance with yet-to-be-developed guidelines. (This funding is displayed in the community colleges' budget, but could flow to any K-14 LEA.) Senate Republicans encourage K-12 and community college districts to work cooperatively to ensure the success of the new regional consortia.

Agricultural education and specialized secondary programs protected. The 2015-16 budget maintains existing funding of $4.1 million for agricultural education incentive grants and $4.9 million for specialized secondary programs. The Governor appears to have abandoned his efforts to eliminate these stand-alone categorical programs and fold their funding into the LCFF. Senate Republicans welcome the continuation of the agricultural education program, which, along with other CTE programs, has been a longstanding budgetary priority.

Child care and preschool programs expand without program reforms. The Governor's 2015-16 budget proposal provides a $101 million augmentation ($133 million in non-Proposition 98 General Fund, offset by smaller reductions in Proposition 98 and federal funds) for continued implementation of the multi-year child care and state preschool expansion plan launched in 2014-15. Unfortunately, it does nothing to improve the weak program integrity highlighted in a 2010 report by the Senate Office of Oversight and Outcomes, which found that "the current system amounts to a merry-go-round of disincentives in which those who oversee the program would rather not know about fraud or feel powerless to address it."[4] That report's suggested reforms of random, unannounced visits to child care

[2] Poverty is measured by eligibility for free or reduced-price lunches.
[3] A student who falls into one of these three categories is funded the same as one who falls into all three.
[4] http://sooo.senate.ca.gov/sites/sooo.senate.ca.gov/files/child%20care%20report.pdf

providers to assure that children are present at the times claimed, and funding for fraud investigators, have gone unheeded.

Fiscally irresponsible local budget reserve restrictions remain. The 2014-15 education budget trailer bill imposed unfortunate new restrictions on schools' ability to grow and maintain healthy rainy-day reserves to insulate themselves from unplanned fiscal events.[5] The new restrictions were unveiled by legislative Democrats at the 11th hour and became available for public review only two days before the Legislature passed the majority-vote budget package to the Governor. They have been condemned by every major education advocacy group in the state, with the exception of the teachers' unions. Senate Republicans vehemently opposed the restrictions based on their fiscal imprudence and potentially disproportionate impact on schools with high populations of low-income students, English learners, and foster youth. Unfortunately, the Governors' 2015-16 budget proposal makes no proposal to unwind them, although it does state that "the Administration appreciates the concerns expressed by stakeholders regarding potential caps on school district reserves and will engage in a dialogue with these groups in the coming months to protect the financial security and health of local school districts." Senate Republicans continue to support the effort made by last year's AB 146 (Olsen/Fuller) to reverse these highly-objectionable restrictions.

Governor continues to oppose students in Vergara v. California. The Governor makes no indication that he has changed his decision to appeal the initial court decision in Vergara v. California. The state's appeal effectively prioritizes teachers' employment rights over the welfare of students by defending practices that, according to Superior Court judge Rolf Treu's decision, have "direct, real, appreciable, and negative" impacts on students and violate their constitutional right to an equal education (e.g., by allowing less effective but more senior teachers to remain in the classroom while more effective but less senior ones are laid off). **Senate Republicans urge the Governor to drop the state's appeal of Judge Treu's ruling and allow it to take effect.** As Senate Republican leader Bob Huff has stated, "Literally millions of California school children are being hurt by the current system. Getting stuck in a classroom with a teacher who doesn't belong there sets kids back, sometimes in ways they may never recover from. We can't wait for a few years while the appeals run out. Judge Treu prescribed legislative action to address this issue. We have a legal and a moral obligation to start fixing this problem now."

No more state school facilities bonds. The Governor's 2015-16 Budget proposes to develop a new approach to school facilities funding, under which the state would no longer take on new debt for school facilities. Instead, schools' ability to fund facilities on their own would be enhanced by 1) allowing local bond caps to rise at the rate of inflation to boost the ability of school districts to fund facilities on their own, 2) replacing existing multi-tiered developer fees with one uniform fee which would fall somewhere between the current Level II and Level III (50 percent to 100 percent of project costs), subject to local negotiation, and 3) expanding the permissible uses of funds in existing restricted maintenance accounts to include new school construction and modernization so that schools could save over time for significant facilities projects. The only state funding provided would be for districts whose assessed property value is so low that they lack capacity to issue local bonds sufficient to meet student needs.

Charter school facilities funding grows. The Governor's proposal also provides $50 million to expand the existing Charter School Facility Grant Program for students in high-poverty areas. This is "pay as you go" funding which, unlike state school facility bonds, does not increase state indebtedness. Senate Republicans are highly supportive of charter schools, as they provide innovative and effective educational experiences to many students, particularly low-income students who are not well served by traditional government schools.

[5] See Section 27 of SB 858 (Ch 32/2014), the 2014-15 omnibus education budget trailer bill.

Schools' broadband infrastructure enhanced. The Governor's 2015-16 Budget provides $100 million in one-time funding for a second round of broadband infrastructure grants (the 2014-15 budget provided about $27 million in one-time funding for the same purpose). These grants are intended to ensure that the state's new testing system, under which most students will take computer-based tests, is functional statewide. This funding will be especially welcomed by remote rural schools who have had difficulty securing service in the open market.

Proposition 39 energy efficiency funding rises. The 2015-16 budget proposal provides $359.7 million in Proposition 98 funding for Proposition 39 energy efficiency projects at K-12 schools ($320.1 million, up from $279 million in 2014-15) and community colleges ($39.6 million, up from $37.5 million in 2014-15).

Teacher preparation program reforms. The 2015-16 budget proposal provides about $7.5 million for the first year of a two-year, $10 million effort to develop a new administrator performance assessment for school principals and revise existing teacher performance assessments ($4 million) and to streamline teacher preparation program accreditation ($3.5 million).

Local library funding flat. The 2015-16 budget continues the 2014-15 budget's augmentations to local library funding ($2 million for the California Library Services Act, which supports inter-library lending, and $1 million for adult literacy programs) but makes no further changes. Republicans have traditionally supported funding for local libraries. The adult literacy program is an especially efficient use of state funding, as it makes use of local volunteers.

California Community Colleges (CCCs). Under the Governor's 2015-16 budget proposal, the community colleges' share of Proposition 98 funding (excluding that for adult education which the Administration does not count for purposes of the statutory K-12/CCC "split" of Proposition 98 funding) rises from $6.41 billion in 2013-14, to $6.90 billion in 2014-15 (a year-over-year increase of $489 million), and again to $7.13 billion in 2015-16 (an increase of $228 million). In addition to the mandates, deferrals, and adult education proposals discussed above, the most notable adjustments in the CCC budget include:

- $125 million for increased operating costs (facilities, professional development, converting part-time to full-time faculty, retirement benefits, etc.)
- $107 million for two percent enrollment growth, to be allocated through a new formula developed by the CCC Board of Governors that prioritizes districts with the greatest unmet need in terms of adequately serving their communities.
- $100 million for student success programs (orientation, assessment, placement, counseling, etc.)
- $100 million for "student equity plans" intended to close achievement gaps between underrepresented student groups and their peers.
- $92 million for a 1.58 percent cost-of-living adjustment.
- $49 million to increase funding for former "enhanced non-credit" courses.[6]
- $48 million to continue CTE education formerly funded through the expired Quality Education Investment Act.
- $29 million for CCC apprenticeship programs ($14 million for existing programs, and $15 million for new programs focusing on emerging industries and unmet labor demand).

[6] This is consistent with a change made last year to motivate the colleges to enroll underprepared students in the classes most appropriate for them rather than pushing them into classes in which they are not likely to succeed, but for which the state pays a higher rate.

University of California (UC) and California State University (CSU). Consistent with his own multi-year funding plan for UC and CSU, the Governor's 2015-16 budget proposal includes a four percent increase in base General Fund support for both segments (about $119 million each), contingent on their agreement not to increase tuition for the duration of the plan, which runs through 2016-17. The chart below reflects proposed funding for UC and CSU:

UC & CSU Funding at 2015-16 Governor's Budget

(Core funds, in millions)

		2013-14	2014-15	2015-16	change
UC	General Fund 1/	2,844	2,991	3,131	140
	Tuition and Fees 2/	3,664	3,790	3,790	0
	Other UC Core Funds 3/	314	323	323	0
	Lottery	31	39	39	0
	Total UC	$6,853	$7,142	$7,283	$141
CSU	General Fund 1/, 4/	$2,769	$3,026	$3,179	$153
	Tuition and Fees 2/	2,764	2,778	2,797	19
	Lottery	36	59	59	0
	Total CSU	$5,569	$5,863	$6,034	$171
	Total	$12,422	$13,005	$13,317	$312

1/ Includes general obligation bond debt service & (for 15-16) $25m each for UC and CSU deferred maintenance.
2/ Includes systemwide fees before discounts/waivers, and nonresident tuition.
3/ Includes application fees, interest, and a portion of grant overhead and patent royalty income.
4/ Includes funding for CSU retired annuitant health care costs.

Source: Legislative Analyst's Office

UC and CSU have each requested about $100 million more General Fund than the Governor's plan provides, and under the Governor's plan, each segment would each unilaterally determine how many students to admit. Absent the additional requested funds, it is unclear that either segment would continue to admit all qualified students.[7] In an effort to persuade the Governor to provide additional funds beyond his planned four percent augmentation, the UC Regents in November 2014 authorized President Janet Napolitano to raise systemwide undergraduate tuition by up to five percent each year for the next five years, and to increase out-of-state enrollment and reduce in-state enrollment if its request for additional funding is not granted. At that same meeting, the Governor, who is a Regent himself, opposed those actions and asked that UC instead begin reducing its cost structure by 1) identifying pathways for three-year graduation, 2) developing common lower-division major requirements across all campuses, 3) offering high-enrollment online courses, 4) granting credit for work experience and military training, and 5) developing differentiations and consolidations among campuses. His 2015-16 budget proposal makes the release of UC's $119 million augmentation specifically contingent on 1) no increase in tuition, 2) no increase in out-of-state enrollment, and 3) unspecified actions taken by the Regents to reduce UC's cost structure, pursuant to recommendations by a new committee to be staffed by the Administration and the UC Office of the President. Senate

[7] The state's 1960 Master Plan for Education calls for UC to admit students from the top 12.5 percent of public high school graduates and all qualified community college transfers, and for CSU to admit students from the top 33.3 percent of public high school graduates and all qualified community college transfers.

Republicans stand with students, teachers, and families in calling for reductions in tuition and other costs. However, it is imperative that both UC and CSU be funded at a level sufficient to ensure that every qualified California student is admitted, and to enable full-time students to graduate in four years. Funding enhancements should *not* be used to expand the segments' administrative structures nor to increase already-inflated executive compensation.[8] **College should be affordable for all Californians, and every qualified California student who wants to attend our state universities should be admitted. We will continue to fight on their behalf to ensure that state government is responsive to their needs, hopes, and dreams.**

CSU innovation awards for reduced time-to-degree. In an effort to motivate CSU to reduce its system-wide average time-to-degree from the current 4.7 years, the Governor's proposed budget includes $25 million for innovation awards to recognize CSU campuses that implement innovations leading to more timely degree completion. Details will be provided when the Administration's education trailer bill is released in February 2015.

Student financial aid grows. The Governor's 2015-16 budget proposal provides a total of $2.23 billion (including $1.93 billion General Fund) for student financial aid. Significant adjustments to student aid funding include:

- Increases of $69 million in 2014-15 and $198 million in 2015-16 for growing Cal Grant costs, bringing the 2015-16 total to just over $2 billlion.
- A $45 million increase for Middle-Class Scholarships, bringing the 2015-16 total to $152 million.
- $15 million to backfill expired federal funding for Cal-SOAP, a student outreach program.
- $840,000 and three positions to begin modernizing the Student Aid Commission's grant delivery system.

CalGrants for private schools fall. The 2014-15 budget included $9 million for a one-year deferral of an existing scheduled statutory reduction of the maximum award amount for students attending private non-profit colleges (from $9,084 to $8,056 per year). The Governor's budget proposal would allow the reduction to proceed.

[8] For example, 16 staff in one office alone (UC's Office of the President) already earn more than the Governor's salary of about $174,000: http://www.dof.ca.gov/budget/historical/2014-15/salaries_and_wages/documents/6000.pdf

Employee Compensation

It's Good to be a Government Employee in California. Not only have the state employee furloughs ended (furloughs that saved more than $800 million total funds, $400 million General Fund in 2012-13), but pay raises and merit salary adjustments increase compensation costs every year. The 2015 budget includes an additional $560.4 million ($203.1 million General Fund) for employee raises and increases in health and dental benefits, bringing the **total cost of state employee salaries and benefits to about $25 billion**. Since 2006-07, base employee compensation costs have increased $3.6 billion ($1.7 billion General Fund), and cumulatively, employee compensation increases have resulted in an additional $21.3 billion ($10.6 billion General Fund) of state employee compensation expenditures at the same time taxes and fees have been increased by tens of billions.

California will continue to spend more for government employees than almost all other states. California currently has the 4th highest level of monthly earnings for state, local and federal employees ($4,789 per month) behind Washington D.C. ($6,069), New York ($4,888), and New Jersey ($4,849), ranking near the top nationally in how much government workers earn according to the new U.S. Census Bureau data. **And not only does California pay more than most, California is home to more public employees than any other state, with 11 percent of the nation's total government workforce** (the next closest state is Texas with eight percent of the workforce). The continuing trend of increased employee compensation, health and retirement costs will eventually require a larger percentage of the state's General Fund resources, leaving the state with no choice but to increase college tuition and reduce resources for vital programs such as K-12 education, public safety, and the social safety net.

Stockpiling Vacation Creates Huge Liabilities. In addition to getting paid more than most government workers, state employees are also banking excess hours of vacation time, leaving the state on the hook for hundreds of millions of dollars. California has a vacation cap of 80 days (16 weeks) which is among the most generous nationwide. Most workers across the country have a finite amount of vacation. **Many companies, as well as some states have use-it-or-lose-it policies that keep employees from carrying over limitless amounts of vacation.** The state relies on heads of state agencies to enforce the cap, but it is a "soft" enforcement, meaning employees can continue to accrue vacation above the cap. Some departments operate 24 hour-a-day facilities (like prisons) and don't have enough extra staff to fill in for employees on leave. Additionally, furloughs made the problem worse as workers banked more vacation time as they used furloughs for time off. Correctional officers actually obtained a contract in 2011 that allows them to carry over as much vacation as they want. **Allowing unions to negotiate for unlimited vacation carry over and failing to enforce the limits in other departments presents a major fiscal problem as the state hasn't set aside money to pay for all the unused vacation when employees cash out.** The state will need to take action to require state departments to manage vacation time over the next decade as the current method of accrue as much as you want is just pushing debt further and further out.

Four Bargaining Units with Expiring Contracts in 2015. Of the 21 bargaining units (BU), 17 bargaining units have contracts in place through July 1, 2016 (with the exception of BU 5-California Highway Patrol which expires July 3, 2018 and BU 8- Firefighters which expires July 1, 2017). Four BU's (about 52,800 employees out of 200,000 included in the 21 bargaining units) will be seeking new agreements in 2015. These include BU 6- Corrections, BU 9-Professional Engineers, BU 10-Professional Scientific, and BU 12- Craft and Maintenance, whose contracts expire between June 30, 2015 and July 2, 2015 depending on the bargaining unit. Although there has been no indication from the Administration whether or not these bargaining units will have new contracts before July, it is likely the Legislature will see legislation seeking approval of new agreements before July 1, 2015.

The Administration's proposal to seek additional contributions from state employees to begin prefunding retiree health care will likely lead to new agreements including these concessions. It will be important for the state to minimize the cost of contract concessions agreed to as offsets to the pre-funding strategy. If concessions were to include salary increases for example, as has been the case in the past, long-term state pension costs would increase, potentially mitigating any benefit from the proposal to have state employees begin prefunding retiree health care.

Unspoken Automatic Pay Increases. The new state spending increases for state employees are in addition to merit salary adjustments (MSA's) that have quietly increased baseline spending on employee wages by nearly $900 million since 2005-06, cumulatively costing the state $4.3 billion. Merit salary adjustments are automatic salary increases, and are not affected by furloughs or personal leave programs. Auto pilot pay raises should not occur while core government services to California's families are reduced and taxes raised. Annual pay increases should not be considered an entitlement for public employees, but should be tied to performance, which is the intent of "merit" pay after all.

State Employee Numbers Begin to Grow Again. The 2015-16 Governor's Budget includes 363,342 state personnel years, including the UC and Community Colleges, which is a three percent increase over 2014-15 (7,750 additional personnel years). With another year of growth in state positions (two percent growth in 2014-15, 7,058 positions), it looks like the Governor is done with his years of restricting bureaucracy.

Personnel Years by Agency

Agency	2013-14	2014-15	2015-16	Change in Positions 15-16 to 13-14	Percentage Change 15-16 to 13-14
Government Operations	14865.6	15,030.6	15134.1	268.5	2.0%
Business, Consumer Services , and Housing	5409.4	5,552.4	5593.2	183.8	3.0%
Transportation	39014.5	39,636.0	39719.5	705	2.0%
Resources	19239.3	19,517.8	19842.7	603.4	3.0%
Environmental Protection	4939.5	5,442.2	5626.7	687.2	14.0%
Health and Human Services	32617.5	33,140.8	33406.9	789.4	2.0%
Corrections and Rehabilitations	60848.6	60,896.6	61667.6	819	1.0%
K-12	2,845.3	2,852.4	2849.9	4.6	0.0%
Community College/Other	330.9	334.5	338.5	7.6	2.0%
Higher Education	133,068.1	136,771.2	136771.2	3703.1	3.0%
Labor and Workforce Development	11808.6	11,513.3	11524.8	-283.8	-3.0%
Other (Gen Govt, Legislative, Judicial, Executive)	28,992.1	30,350.1	30866.6	262.2	1.0%
Total	**353979.4**	**361037.9**	**363341.7**	**7750.0**	**3.0%**
Higher Education	-133068.0	-136771.2	-136771.2		
Legislative, Judicial	-2736.0	-2734.8	-2735.3		
Total Executive Branch	**218175.4**	**221531.9**	**223835.2**	**5659.8**	**3.0%**

[1/] Government Operations Agency created with 2013-14 budget. Includes PERS, STRS, FTB and other oversight depts such as DGS, DHR, CTA, SPB.

[2/] Various Org 9901was carrying a lump sum unallocated cut of -16,000.0 positions.

*** Department of Finance Schedule 4**

Health & Human Services

The proposed 2015-16 Governor's Budget includes total expenditures of $125 billion for all Health and Human Services (HHS) Agency budgets. General Fund expenditures for HHS are projected to be $32 billion, which represents an increase of $1.4 billion (4.7 percent) from the revised 2014-15 budget. Significant factors driving this General Fund cost increase include:

- $219 million to expand Medi-Cal eligibility under federal health care reform.
- $100 million to address the costs of certain high-cost Hepatitis C drugs that are provided though Medi-Cal and other health programs.
- $316 million to pay overtime to In-Home Supportive Services (IHSS) providers.
- $73 million to provide for two recent five percent grant increases in CalWORKs, both fully implemented in 2015-16.

Significant State Resources Already Committed to Low-Income Residents. Senate Republicans have pointed out previously that the state has long been generous in funding programs that benefit low-income Californians. The Governor's Budget Summary (page 8) echoes this observation when it accurately states,

> "Compared to other states, California provides broader health care coverage to a greater percentage of the population, including in-home care, and guarantees access to services for persons with developmental disabilities. California makes available higher cash assistance to families, continues that assistance to children after their parents lose eligibility, and provides extensive child care to working families with children up to age 13. Finally, the state provides generous financial aid to those seeking higher education."

The Governor's point should be kept in mind as legislative Democrats begin seeking to launch new health and social services programs. Rather than simply always calling for more of these programs, stakeholders should recognize that California's problems of poverty and inequality do not stem from a lack of HHS programs. The state faces challenges simply to meet commitments already made through programs like Medi-Cal and Developmental Services, where low reimbursement rates from the state threaten to put care providers out of business. Efforts to address California's continuing problems with poverty and inequality instead must focus on sustaining or improving the effectiveness of current HHS programs or on increasing educational and work opportunities. Please see *Appendix B-California Safety Net Facts, on Page 50,* for a summary of how California compares to other states on key programs.

Health

The 2015-16 Governor's Budget for Health programs continues to implement federal health care reform but also proposes to expand or renew significant Medi-Cal taxes and fees. Key changes are discussed in more detail below. The following table summarizes proposed General Fund spending levels and significant cost factors for the largest health departments.

Summary of Department General Fund Spending *Dollars in Millions*					
Department	**2014-15 Revised Estimate**	**2015-16 January Proposal**	**Change from 2014-15 to 2015-16**		**Key Changes From Prior Year**
			$	**%**	
Health Care Services: Medi-Cal	$ 17,840	$ 18,611	771	4.3%	Increased funds for new Medi-Cal enrollees following Affordable Care Act implementation. Loss of federal funds that provided temporary savings. New Behavioral Health Treatment benefit for autism.
Health Care Services: Family Health	$ 113	$ 211	98	86.7%	Loss of federal "waiver" funds that offset General Fund savings in 2014-15.
Developmental Services	3,098	3,300	202	6.5%	Caseload and utilization cost increases. New costs for state minimum wage and sick day mandates.
Public Health	120	124	4	3.3%	Biology laboratory improvements.

Medi-Cal

Health Reform Costs and Enrollment Explode. The expansion of Medi-Cal eligibility associated with the federal Affordable Care Act (ACA) became effective January 1, 2014. The Governor's budget does not propose significant changes to the method of implementation, but instead provides updated cost and enrollment information. Key effects of the ACA on Medi-Cal include enrollment increases from the prior year of 26.0 percent in 2014-15 and 2.0 percent in 2015-16, reaching a caseload of 12.2 million, or more than 50 percent higher than Medi-Cal caseload only three years earlier. **Following this enrollment explosion, Medi-Cal now covers 32 percent of the California population, or nearly one in three residents.** Enrollment expansion groups and their related costs are summarized in the table on the next page. The only factor preventing fiscal calamity for California at this point is that the federal government is currently paying most of $18 billion cost for the expansion in 2015-16. However, the state share is still substantial and, as Governor Brown noted in his budget speech, will increase by an additional $1 billion or more by 2020 on top of the current spending levels.

Medi-Cal Health Reform Enrollment and Benefit Costs
Dollars in Millions

Enrollment Group	Avg. Monthly Eligibles		Total Costs		General Fund Costs	
	2014-15	2015-16	2014-15	2015-16	2014-15	2015-16
Mandatory Expansion: Children and parents	269,146	384,199	$ 1,604	$ 2,020	$ 762	$ 961
Optional Expansion: Adults without children	1,967,870	2,012,616	12,583	14,320	7	7
Newly qualified immigrants	18,407	11,934	135	96	49	35
Express Lane Eligibility	192,458	178,342	1,310	1,223	15	15
Hospital presumptive eligibility	36,024	34,307	499	690	91	125
Total	**2,483,905**	**2,621,398**	**$ 16,131**	**$ 18,349**	**$ 924**	**$ 1,143**

Source: January 2015 Medi-Cal Estimate

Problematic New Managed Care Tax Proposed. The Governor's budget proposes to replace the existing managed care organization (MCO) tax with a broader MCO tax intended to meet new requirements recently issued by the federal government. Under these new federal rules, the current tax would not be renewed after its expiration on June 30, 2016, because it only applies narrowly to Medi-Cal managed care plans. **The Governor's budget proposes an MCO tax that would apply to all managed care plans regardless of whether they currently serve Medi-Cal or pay the current tax.** In addition, the Governor proposes to increase the amount of funds raised by $216 million to not only replace current MCO tax revenues for Medi-Cal, but also to fund the restoration of a previous seven percent reduction to the In-Home Supported Services (IHSS) Program.

The Governor's proposal to replace the current MCO tax with an expanded version appears premature and ill-advised. More specifically:

- The new proposal is premature because the current MCO tax does not expire until the end of the 2015-16 budget year. Replacing the current version is an issue for 2016-17, not this budget year.
- The Governor's proposal would once again alter the purpose of the MCO tax, which Republicans initially supported in 2009 as a means to maintain the Healthy Families Program. In subsequent versions of the tax, health plans paying the tax at least were the same plans who served Medi-Cal and thus benefitted from the higher reimbursement rates supported by the tax. Now, health plans that do not serve Medi-Cal will be included. Additionally, $216 million in higher tax revenue is intended to increase spending on the unrelated IHSS program because the Brown Administration entered into a court settlement agreement with IHSS providers to seek a provider tax to supplement funding for that program. **Republicans did not support that agreement and have no reason to support a new tax that would include non-Medi-Cal health plans to fund it.**
- The uses of the current MCO tax remain unclear because the Department of Health Care Services still has not provided all reports required to document how the revenues are spent. Republicans will hold the Administration accountable and ensure all the currently required information is provided before considering a replacement tax.

Nursing Home Fee Renewal. The Governor's budget also proposes to extend the current quality assurance fee (QAF) imposed on nursing facilities, which expires July 31, 2015, for a period of five years. The proposal would generate nearly $540 million in General Fund savings in the budget year, include annual rate increases of 3.6 percent, and maintain current levels of funding for related quality-based supplemental payments. **Extending the QAF would require a two-thirds vote in both houses.** Many current Senate Republicans supported the previous extension of a similar fee in 2012. The current proposal appears similar to previous versions, but additional details are needed before considering the QAF.

Notable Omissions. Conspicuously absent from the Governor's budget proposal are the following:

- ***Provider Rate Restorations.*** The 2013 Budget Act implemented Medi-Cal provider rate reductions of up to 10 percent for most provider types, despite bipartisan legislative efforts to reverse that action. The Governor's budget for 2015-16 estimates the savings from the existing reduction to be $225 million General Fund, and provides no new relief to Medi-Cal providers. Continuing down the path of reducing provider payments at the same time that Medi-Cal enrollment expands to nearly one-third of California's population will result in a program that does not work well either for care providers or the people who depend on them. The Legislative Analyst's Office and the California State Auditor have pointed out that Medi-Cal provides less access to physicians and dentists than other types of health insurance.

- ***Federal Executive Order for Immigration.*** The Governor's budget does not provide any funding for low-income undocumented immigrants who may be eligible for full Medi-Cal benefits following President Obama's executive order regarding "deferred deportation." Some advocates have argued that members of this group who meet income requirements would be eligible for Medi-Cal with no further legislation, but the Brown Administration has expressed uncertainty. Costs to provide full Medi-Cal benefits are unknown but could be substantial. Undocumented immigrants are currently eligible to receive emergency room care through Medi-Cal as well as some other benefits such as long-term care.

Department of Developmental Services

The Department of Developmental Services (DDS) estimates it will serve over 289,000 developmentally disabled Californians in 2015-16 in community settings and institutional developmental centers (DCs). While the vast majority of these individuals receive community-based services, the Governor's budget projects that DCs will serve 1,116 residents in 2014-15 and 1,010 residents in 2015-16, a decline of 106 residents (9.5 percent). In contrast, the number of individuals served in community settings is projected to grow to 288,317 in 2015-16, an increase of 3.1 percent over the revised 2014-15 caseload.

DC Woes Deepen, Creating a Budget Shortfall. The Governor's budget projects DC expenditures of $563 million total funds for 2014-15, which exceeds the enacted budget by $35 million ($34 million General Fund). Roughly half of the **deficiency is related to the DCs' failure to meet federal health and safety requirements,** including lost federal reimbursements of $8.8 million following Sonoma DC's failure to regain federal certification, as well as increased staffing costs of $7.5 million that DDS claims are needed to meet federal standards at Fairview DC and Porterville DC. For the DCs in 2015-16, the Governor's budget proposes an overall decline of $48 million (8.5 percent) to $515 million total funds ($280 million General Fund). **However, the average cost *per DC resident* would rise from $475,000 enacted for 2014-15 to over $510,000 in 2015-16, an increase of 7.4 percent.**

Lanterman DC Closure Costs Continue. A budget action taken in 2010-11 began a gradual process of closing down Lanterman DC in Pomona, and the Governor's budget indicates that the last Lanterman resident moved out in December 2014. The Lanterman DC property is expected to transfer to the California State University system on July 1, 2015. However, costs for Lanterman DC are budgeted at $68 million in 2014-15 and $21 million for 2015-16, including “warm shutdown” operating expenses and funds to resolve workers’ compensation claims.

Budget Shortfall for Community Services. The Governor’s budget projects that current year costs for Community Services will exceed the enacted budget by $159 million total funds ($102 million General Fund). The Administration attributes this deficiency primarily to higher-than-expected costs of $111 million for caseload and utilization as well as lower-than-expected savings of $44 million related to shifting behavioral health costs to Medi-Cal and private insurers.

More Changes Needed to Sustain Community Service System. The Governor’s budget proposes $5.1 billion total funds ($3.0 billion General Fund) for Community Services in 2015-16, an increase of $452 million total funds. However, this increase is attributed to higher caseload and utilization, the loss of behavioral health savings, and higher costs for state and federal labor mandates. Conspicuously **absent are any programmatic proposals to shore up the viability of the community system so that it can continue to empower disabled individuals to live and pursue their goals in their own neighborhoods.** For example, rates for many types of community providers were frozen or cut in the past decade, even as the state imposed new regulatory burdens on those same providers. **In contrast, state civil service workers in the DCs received numerous pay increases during the same period.** The DCs’ continuing health and safety problems and the increase in costs per resident reflect ongoing management problems, suggesting that the drawn-out closure of DCs and transition of residents to community care settings should be accelerated. This could allow funds now spent on DCs to shore up Community Services instead. Although the HHS Agency is currently convening a Developmental Services Task Force process to discuss ways to strengthen the community system, more aggressive action is needed. **Senate Republicans call for California to reaffirm its commitment to the original vision of the Lanterman Act and ensure that developmentally disabled people can thrive in a sustainable community environment.**

Human Services

CalWORKs

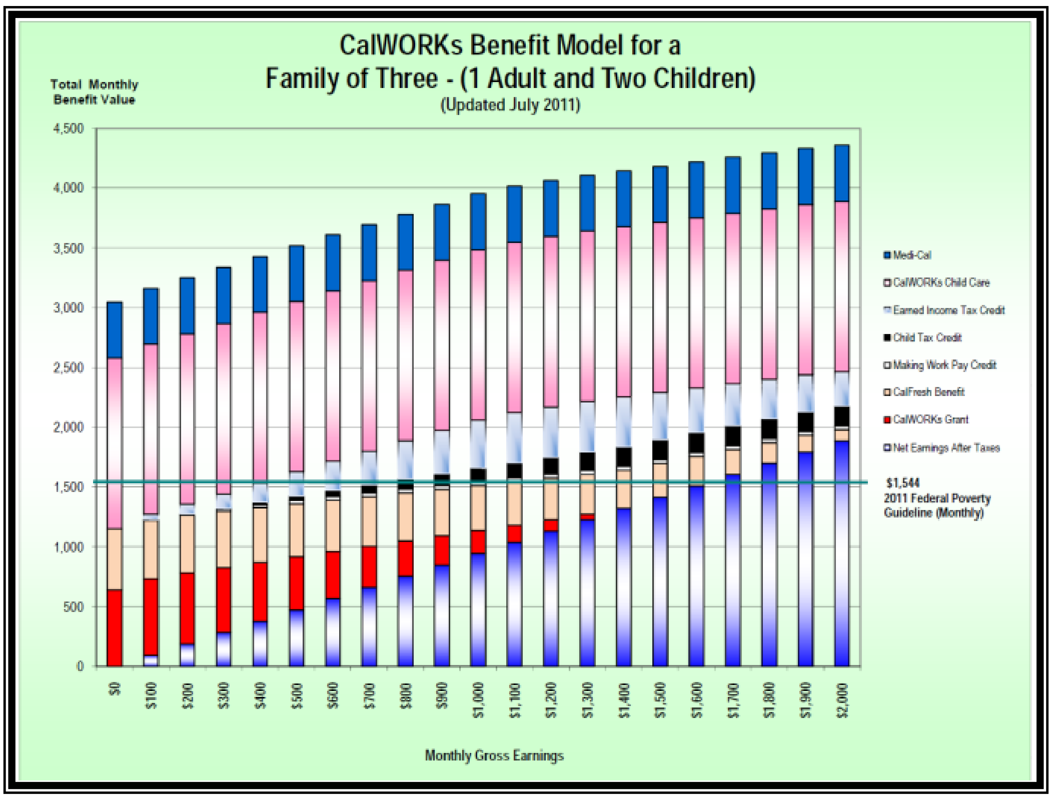
The CalWORKs program provides temporary cash assistance and welfare-to-work services to low-income families with children. The 2015-16 Governor’s Budget proposes $5.8 billion ($1.9 billion General Fund) in 2015-16 for the program and estimates a caseload of 529,000 families (a decrease of less than one percent from the revised 2014-15 caseload).

The 2015-16 budget includes the following expenditures within the CalWORKs program:

- **Welfare Grants on the Rise**. $340.5 million ($267.2 million in 1991 Realignment funding and $73.3 million General Fund) in 2015-16 to fully fund two five percent CalWORKs grant increases that were implemented March 1, 2014 and April 1, 2015.
- **Drug Felons Now Eligible for Cash Grants.** The 2015-16 Governor’s Budget includes $8.2 million for the cost of providing both CalWORKs and CalFresh benefits to drug felons (this eligibility expansion was included in the 2014 Budget Act). Approximately 3,900 CalWORKs child-only cases will have a newly eligible drug felon adult receiving cash assistance which violates past policies and common sense.
- **No Plan to Improve the State’s Welfare System.** The Governor’s budget noted that “investing in assistance programs alone will only marginally improve the situation for those living in poverty.” But while the Governor’s budget does not further unwind recent welfare reforms, it fails to include any new accountability measures. California’s social safety net needs to be transformed. The current system asks little of those receiving benefits and provides

disincentives to work while failing to require development of basic skills that allow those on welfare to become productive. For example, 47 percent of welfare recipients don't have a high school diploma and California doesn't require they even try to get one. California needs the type of investment that can provide a permanent path out of poverty and to greater personal advancement.

State Policies May Create Disincentives to Succeed. The state's entitlement programs could be creating disincentives for recipients to succeed and become self-sufficient because they fail to provide any incentive for people to become self-sustaining and risk losing the guarantee of cash assistance. As the most recent (2011) chart from the Department of Social Services below shows, a family of three with $0 in annual earnings receives the equivalent of $36,000 annually in government-provided assistance and services from the state (additional county services not reflected on chart). A family earning $1,000 a month can receive nearly $4,000 a month in cash assistance and services from programs such as Medi-Cal, CalWORKs, Cal Fresh, child care and other programs.



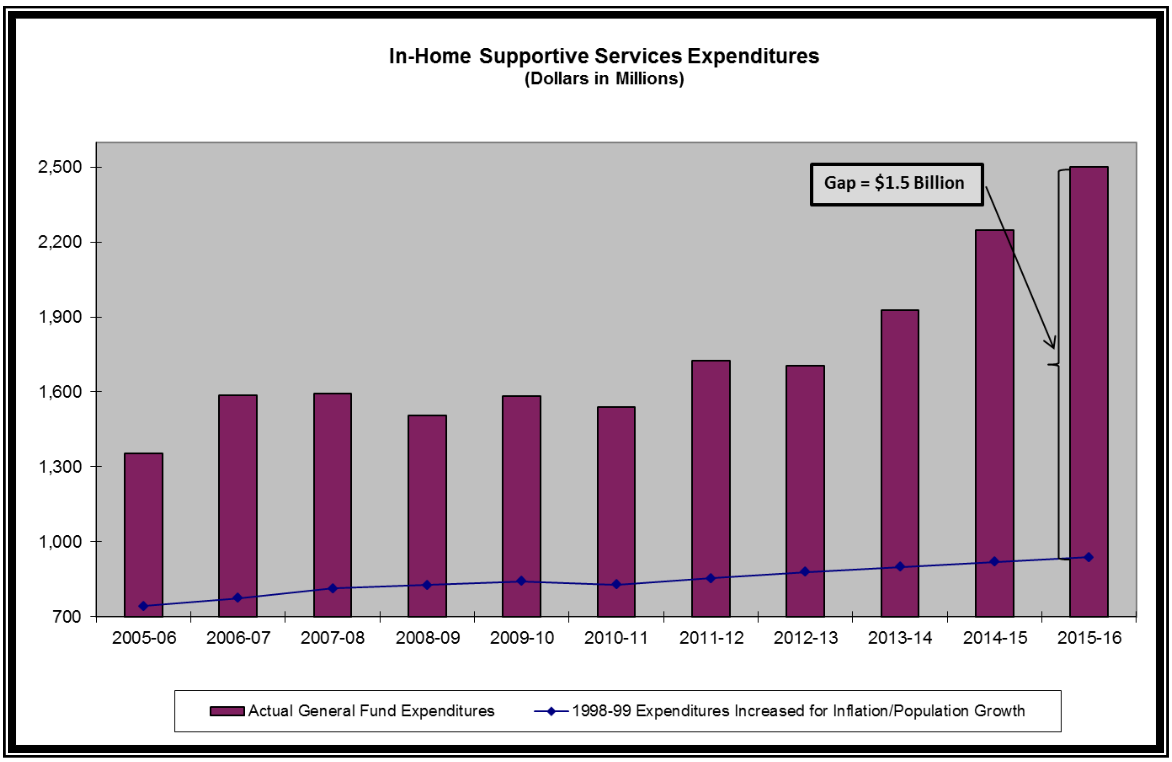
In-Home Supportive Services

The In-Home Supportive Services (IHSS) program provides personal care and domestic services to approximately 450,000 low-income individuals who are aged, blind, or have disabilities. The budget includes $8.2 billion ($2.5 billion General Fund) in 2015-16, a 14.4 percent increase ($1.1 billion total funds [$300 million General Fund]) above the revised 2014-15 Budget. Caseload is estimated to be 463,000 a less than one percent decrease (1,290 recipients) from the 2014 Budget Act.

- **Coordinated Care Initiative (CCI) Driving New Costs in IHSS.** The Coordinated Care Initiative (managed care integration for those eligible for both Medicare and Medi-Cal) was included as part of the 2012 budget as a cost reduction measure. However, several policy assumptions have proven wrong and as a result, the program will actually result in net costs to the state in 2016-17, likely in the hundreds of millions of dollars. Within the IHSS program, the

CCI led to several policy changes that have significantly increased General Fund costs by more than $300 million in 2015-16 such as statewide bargaining and county maintenance of effort, which eliminated counties' incentive to control costs. The Governor acknowledges the CCI is not on track to be cost-effective, which could result in dissolution of the program by January 2017. This could result in a significant level of General Fund savings as counties would again be required to pay for half of the non-federal costs of the program, reducing General Fund as well as providing counties with incentives to control program costs.

- **Eliminates Last Remnants of Reform and Cost Containment.** Program reforms within IHSS such as fingerprinting recipients, fingerprints included on timesheets, investigation of fraud, and unannounced home visits that were included as part of the 2009-10 budget have all been eliminated. In addition to eradicating the reforms, the Governor's budget now includes $483 million in 2015-16 to restore a seven percent reduction in IHSS hours that was part of an IHSS settlement agreement. The Governor proposes to pay for the restoration using proceeds from a new and expanded MCO tax on managed care plans. **IHSS is now back on track to be the fastest growing General Fund program in the state, increasing by $1 billion General Fund, or 57 percent since 2007-08.** As the chart below shows, growth in IHSS General Fund expenditures has surpassed population and inflation program growth by $1.5 billion in 2015-16.



Looming Budget Risks

One reason the Governor called the budget “precariously balanced” is the looming budget risks within the state’s human services programs:

- **Food Stamps Administration Costs.** The U.S. department of Agriculture implemented spending targets for CalFresh administrative expenditures. California will exceed the target of $800 million for federal fiscal year 2015 and could result in a state General Fund backfill of $270 million if the federal government does not provide additional funding for California’s high administration costs.
- **New Undocumented Immigrant Costs.** President Obama announced several executive actions in November intended to allow certain undocumented immigrants to stay in the U.S. and these individuals may be eligible to receive state-funded full-scope Medi-Cal, IHSS, and Cash Assistance Program for Immigrants (SSI/SSP for non-federally eligible individuals). **Although the budget does not assume additional costs for these individuals, costs could easily be in the hundreds of millions of dollars annually.**

Supplemental Security Income/State Supplementary Payment

The Supplemental Security Income/State Supplementary Payment (SSI/SSP) program provides monthly cash assistance to eligible individuals who are aged, blind, or who have disabilities. The 2015-16 Governor’s Budget includes $10.2 billion ($2.8 billion General Fund) for SSI/SSP, an increase of two percent ($237 million total funds [$29 million General Fund]) over the revised 2014-15 budget. The estimated caseload for the SSI/SSP program is 1.3 million recipients in 2015-16, an increase of one percent (8,309 recipients) over the revised 2014-15 budget.

Grants to Increase. The Governor’s budget includes $131 million federal funds to reflect an estimated cost-of-living increase of 1.7 percent in 2015-16 and another 1.5 percent in 2016-17 (the increases are effective January 1 of each year) for the SSI portion of the grant. Effective January 2015, maximum SSI/SSP grant levels are $881 per month for individuals and $1,483 per month for couples. The maximum SSI/SSP monthly grant levels will increase by $11 and $16 for individuals and couples, respectively, effective January 2016.

The budget also includes an increase in state General Fund costs (included in the General Fund increase identified above) for benefits under the Cash Assistance for Immigrants (CAPI) program. The CAPI program provides benefits consistent with SSI/SSP for those legal immigrants not eligible for the federal program. CAPI benefits are equivalent to SSI/SSP benefits, less $10 per month for individuals and $20 per month for couples.

Child Welfare Services

Continuum of Care Reform Implementation Begins. The 2015-16 Governor’s Budget includes $9.6 million ($7 million General Fund) to begin the Continuum of Care Reform (CCR) effort, which was authorized as part of SB 1013 (Budget and Fiscal Review Committee), Chapter 35, Statutes of 2012. The CCR is intended to provide a comprehensive approach to improving the experience and outcomes of children and youth in foster care. Implementation will require a multi-year effort and future costs are unknown at this time, but could be in the tens of millions of dollars. Recommendations range from utilizing a common tool for assessment, requiring foster family agencies be accredited, developing temporary transition strategies, and strengthening recruitment, training and retention strategies, as well as a number of other strategies, all of which will likely require a General Fund commitment from the state. The state faces a number of issues within the child welfare service programs such as inappropriate placements, lack of small family homes, and failing to ensure services are provided as needed for children and foster parents. These reforms are critical to the success of the program and will help to provide greater program transparency as well as improving outcomes for these children and their families. Senate Republicans are supportive of reforms to address these problems.

Community Care Licensing

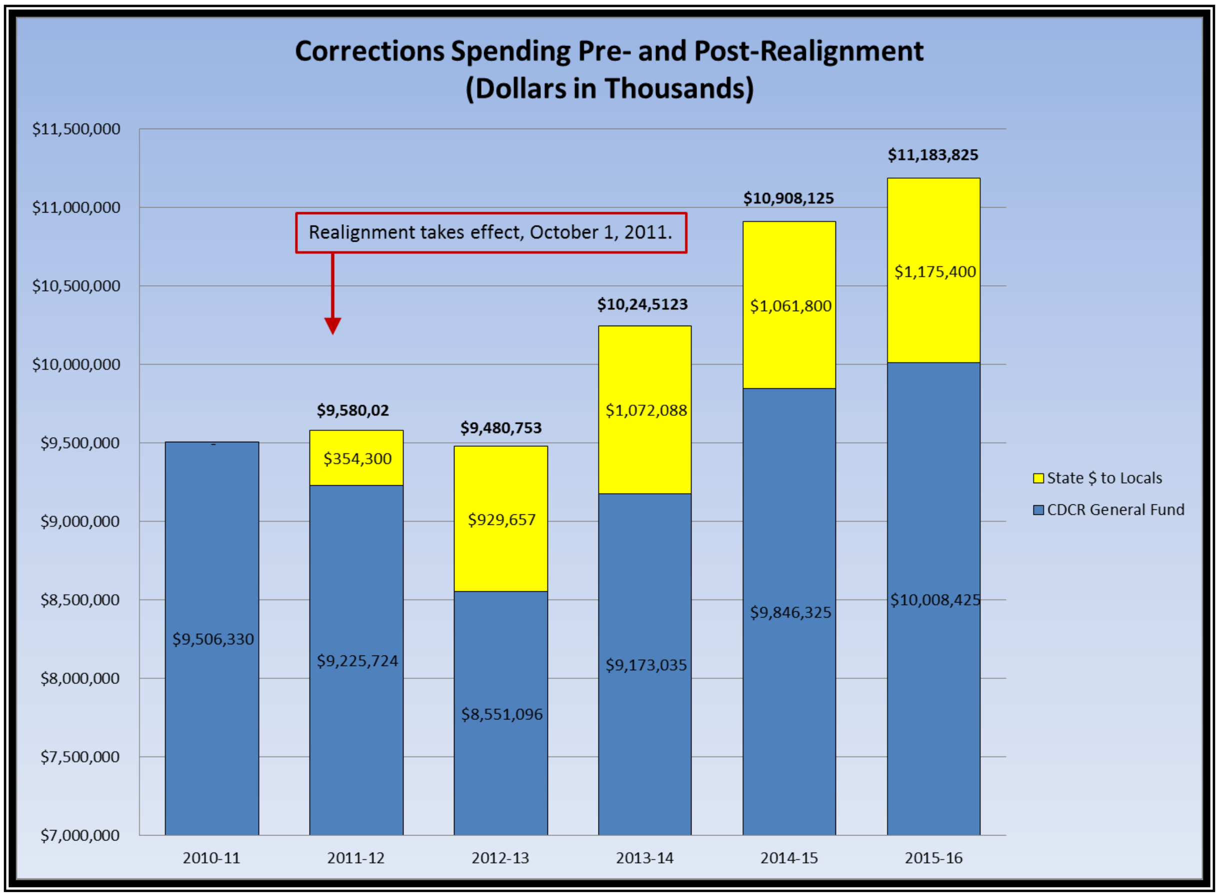
The 2015-16 Governor's Budget includes $118 million ($36 million General Fund) for Community Care Licensing (CCL). CCL oversees the licensure or certification of approximately 66,000 licensed community care facilities, such as childcare centers, family childcare homes, foster family and group homes, adult residential facilities, and residential care facilities for the elderly. The budget includes $3 million General Fund to address a backlog of complaint cases, expand training, and provide technical assistance. The budget also outlines future plans to increase inspection frequency as follows:

- Beginning January 2017, The Department of Social Services (DSS) will increase inspection frequency to every three years for all facilities;
- By 2018, DSS will increase inspection frequency to every two years, except child care; and,
- By 2019, DSS will increase inspection frequency to annual inspections for adult day care and residential care facilities for the elderly.

Public Safety

CORRECTIONS

Despite the Governor's promise of billions of dollars in savings from the 2011 Public Safety Realignment (Realignment), and **despite the Department of Corrections and Rehabilitation (CDCR) reducing its average daily population by more than 24,000 inmates since Realignment took effect, state spending on corrections continues to grow in 2015-16.** As reflected in the chart below, annual General Fund expenditures by CDCR have grown from $9.5 billion in 2010-11 (the last year before Realignment) to a proposed $10 billion in 2015-16. Including state funding provided to local public safety agencies to implement Realignment, total annual state spending on corrections for this population of felons has grown by $1.6 billion since Realignment took effect, to nearly $11.2 billion in 2015-16. A significant percentage of the $1.6 billion in ongoing cost increases over this five-year period is due to increased employee compensation and benefits ($763 million), activation of the California Health Care Facility (CHCF) in Stockton and three new infill dormitories ($330 million), and automatic increases in the amount of funding provided to local agencies for Realignment ($246 million).



CDCR

The Governor's budget proposes 2015-16 General Fund spending for CDCR of $10 billion, which is approximately $460 million above the Budget Act spending level for 2014-15. The increase in spending is comprised mostly of employee compensation and benefits cost increases ($363 million), health care staffing adjustments ($90 million), and the activation of 2,376 new infill beds ($36 million), offset by various population-related reductions.

Activation of New Infill Beds. The Governor's budget includes $35.5 million General Fund in 2015-16 to activate three new dormitory-style infill housing facilities that will add 2,376 beds to the total design capacity of the state's prison system. These three facilities were approved as part of the Budget Act of 2012. Two will be on the campus of Mule Creek State Prison in Ione. The other will be at the Richard J. Donovan Correctional Facility in San Diego. These new infill facilities are expected to be completed by February 2016. They are an essential component of the plan to meet the federal three-judge panel's (3JP) order to bring the in-state prison population to within 137.5 percent of design capacity by February 28, 2016.

Condemned Housing Crisis. All male inmates sentenced to death in California are sent to San Quentin State Prison (SQSP). Between new death sentence cases, overturned convictions, and non-execution inmate deaths, the condemned population increases by approximately 13 inmates per year on average. There are currently 729 condemned male inmates housed at San Quentin, but CDCR only has permanent beds for 690 (plus another 25 unfunded temporary beds), leaving no room for population surges or future population growth. CDCR has managed to date because at any given time, a handful of inmates are either out to court or receiving medical or mental health treatment at an off-site facility. If all condemned inmates who are temporarily away were to return at the same time, the Department would have 14 more inmates than beds. To address this crisis, the Governor's budget includes $3.2 million General Fund to convert two tiers of a non-condemned housing unit at SQSP to condemned beds, which would increase the available number of condemned beds by 97 (from 690 to 787).

With a significant majority of California voters still supporting the death penalty (approximately 56 percent according to a 2014 Field Poll) and no executions in the last eight years, it is highly likely that additional housing will be necessary before any change is made in the system that would reverse the population trend. The Governor's proposal is a reasonable solution that presents a low-cost alternative to new construction.

***Coleman* Compliance: Use of Force and Segregated Housing.** The Governor's budget includes $42 million General Fund to comply with several recent orders from the *Coleman* court regarding CDCR's use of force and segregated housing for certain mentally ill inmates. The recent federal court orders require the Department to provide more clinical staff involvement during use of force events like cell extractions. In addition, they require CDCR to house Correctional Clinical Case Management System inmates (the lowest level of care in the Department's mental health system) that are sent to segregated housing units for behavioral reasons in separate facilities from General Population inmates. While it is unfortunate that the state must pay these costs, history has generally shown that when CDCR fails to show an early good faith effort to comply with court orders, they are usually followed with more onerous and costly court orders.

Recidivism Reduction Update. The Legislature enacted Chapter 310, Statutes of 2013 (SB 105) to ensure the state's ability to meet the 3JP's order to reduce the state's prison population to no more than 137.5 percent of design capacity by December 31, 2013. SB 105 appropriated $315 million General Fund to pay for renewed recidivism reduction efforts and enough contract beds to house any population in excess of the cap as of that date. The bill required a portion of any funding not needed for contract beds to be transferred to the Recidivism Reduction Fund (RRF) and used to reduce the prison population through evidenced-based programming aimed at reducing recidivism. In February 2014, the 3JP approved the state's request for a two-year extension to comply with the population reduction order, thus much of the SB 105 appropriation was not needed for contract beds and was available instead for transfer to the RRF. The 2014 Budget Act assumed there would be $91 million available in the RRF and included a package of programs intended to reduce recidivism, funded in large part by the $91 million.

CDCR received $42 million of the $91 million RRF that was appropriated in the 2014 Budget Act. Due in part to delays in reaching agreements with local agencies to provide services for state prison inmates in community reentry facilities, the Department estimates it will not spend about $16 million of the RRF funds it was allocated for 2014-15. In addition, the Administration indicates that more of the $315 million SB 105 appropriation will not be needed for contract beds than was originally projected, thus increasing the amount transferred to the RRF by $12.2 million and bringing total RRF dollars available for expenditure in 2015-16 to $28.2 million.

- *Revised Recidivism Reduction Plan Lacks Detail and Risks Repeat Failure.* The Governor proposes reappropriating $12.6 million RRF in 2015-16 to contract for community-based reentry services for offenders with co-occurring mental health and drug treatment needs. The Legislative Analyst's Office (LAO) pointed out that the Governor's 2014-15 plan to use some of the RRF funds for community reentry contracts lacked detail and could prove challenging to implement given past difficulty siting reentry facilities.[9] The proposal included in the 2015-16 Governor's Budget is no different. It still includes **almost no detail.** Furthermore, the need to reappropriate funds for this purpose confirms the LAO's concerns about the potential difficulty in contracting for community reentry services.

  The remaining $15.6 million RRF would be used to expand substance abuse treatment programs at state prison facilities. If implemented according to best practices, in-prison substance abuse treatment can be effective in reducing recidivism. However, CDCR has a deplorable track record when it comes to following best practices and successfully implementing evidence-based programs. All in all, this proposal presents a high risk of wasting scarce RRF resources. These funds would be better spent for the collection of data on, and evaluation of, existing offender rehabilitation programs with the purpose of eliminating those that are shown to be ineffective and expanding those proven to be effective.

Receiver

In 2005, after ruling that the quality and availability of the medical care provided to inmates in California's prison facilities amounted to cruel and unusual punishment, U. S. District Court Judge Thelton Henderson placed the prison medical system in receivership. In 2006, he appointed a Receiver to address the problems with the state's prison medical care delivery system. The Receiver is currently responsible for virtually all aspects of prison medical care.

CHCF Activation Problems Continue to Drive Major Costs. In January 2014, just months after opening the doors of the new prison hospital in Stockton, the Receiver abruptly halted intake amid news reports of serious operational issues, including unavailability of medications and medical supplies, conflicts between custody and clinical staff, general failures in plant operations, and a scabies outbreak. Initially, the Receiver's Office placed much of the blame for the problems on custody staff and the learning curve associated with a new warehousing and supply delivery system. It was eventually disclosed that, in addition to those problems, the Receiver had seriously underestimated the mobility of the population of patients being housed within the facility, resulting in the need for more custody staff than originally planned. Now, a year later, we learn that the Receiver also severely underestimated the need for medical personnel. As a result, the Governor's budget includes $76.4 million General Fund to add 715 medical staff positions at CHCF. **The individual appointed by the federal courts to fix the problems with California's prison medical care delivery system has botched several crucial steps in the activation of the medical facility he designed. Republicans believe there needs to be greater accountability for the Receiver and the costs of federal court mandates regarding**

[9] Legislative Analyst's Office. *The 2014-15 Budget: Administration's Response to Prison Overcrowding Order.* February 28, 2014.

prison medical care. To date, the ruling party has done very little to hold the Receiver accountable.

Valley Fever Drives Future Costs. Avenal State Prison (ASP) and Pleasant Valley State Prison (PVSP) are both located in areas where the fungus that causes coccidioidomycosis, more commonly known as "Valley Fever" is known to be present. Following a recent Valley Fever study, the Centers for Disease Control and Prevention released a report suggesting that the use of skin tests for previous exposure to the fungus would improve the identification of individuals least likely to contract the disease (those previously exposed who do not have the disease). This, in turn, would facilitate better decision making with respect to which inmates could most safely be housed at ASP and PVSP. The Governor's budget reflects an increase of $5.4 million General Fund in 2014-15 for Valley Fever skin testing. While no funding is currently proposed for 2015-16, it is highly likely that the testing performed in 2014-15 will lead to operational changes in 2015-16. These changes could include moving inmates and staff who test negative for Valley Fever exposure from ASP and PVSP to other facilities and modifying plans to move prisoners to those facilities if any of the inmates scheduled to be moved have no previous exposure to Valley Fever. The magnitude of costs associated with these changes is unknown at this time, but potentially substantial.

Local Public Safety Realignment Funding

The Governor's budget projects funding for local public safety agencies to manage realigned offender populations of approximately $1.2 billion in 2015-16. This is up from $1.1 billion assumed for 2014-15 in the 2014 Budget Act. Many local sheriffs and probation departments indicate that the funding they are receiving continues to be insufficient to provide the level of rehabilitative programming and services necessary to manage this population and protect public safety**. Republicans believe that if we are to continue down this road, the only hope for success is to provide our local government partners with adequate funds to properly manage and supervise these criminals and provide the necessary recidivism reduction programs like job training, education, drug treatment, and mental health counseling.**

Still No Funding for Data Collection. The Governor and legislative Democrats forced Realignment on the people of California, and in doing so, they failed to include any requirement for local public safety agencies to collect data on outcomes. As a result, there is virtually no data being collected that would allow for the evaluation of the programs being delivered to the realigned population. Realignment requires local agencies to provide evidence-based programming to realigned offenders to reduce recidivism. **Last year, legislative Democrats killed SB 1097 (Nielsen), a common-sense measure introduced by Republicans that would have established local data collection requirements and provided funding to support local agencies in that effort.** The ruling party has thus far refused to put the evidence in "evidence-based programming". The Governor's failure to include funding for this purpose in his budget plan continues Democrats' "head-in-the-sand" approach.

Office of Emergency Services (OES)

Hazardous Materials Fee for Rail Disaster Response. Chapter 663, Statutes of 2014 (AB 1476, Committee on Budget) authorized a $10 million loan from the High-Cost Fund-B Administrative Committee Fund to the Regional Railroad Accident Preparedness and Immediate Response Fund (RRAPIRF), to be used by the OES for railroad tank car hazardous material activities. The Governor's budget proposes to continue this funding in 2015-16 to allow OES to coordinate with local agencies to better prepare for, and respond to, emergencies involving hazardous materials transported by railroad tank car. He would fund the ongoing activities by reestablishing a fee on hazardous materials transported by rail. Shipments of oil by rail are anticipated to increase significantly in the near future, making rail disaster prevention and response an important public safety issue. Legislative Democrats have shown early signs of wanting to leverage this issue to make life more difficult for oil companies engaged in hydraulic fracturing, or "fracking", as a means of extracting crude oil from the earth. It will be important to weigh the public safety benefits of tighter oversight of rail oil shipments against the costs in terms of jobs and the economy going forward.

Department of State Hospitals (DSH)

Incompetent to Stand Trial Patient Backlog. County jails continue to have a backlog of persons deemed Incompetent to Stand Trial (IST) who are waiting for a treatment bed at a DSH facility to become available. The backlog has grown to more than 400 (from 150 in 2012). The 2014 Budget Act provided funding to expand IST capacity by 105 beds and to enhance local Restoration of Capacity programs by up to 55 beds. In a continuation of that effort, the 2015-16 Governor's Budget includes the following:

- *Funding to Activate 105 New Beds.* Provides $17.3 million General Fund to activate the additional 105 beds authorized in the 2014-15 Budget Act, including 55 at Atascadero State Hospital ($8.6 million) and 50 at Coalinga State Hospital ($8.7 million). The 50 beds at Coalinga will be used to treat *Coleman* patients currently treated at Atascadero, freeing up the Atascadero beds for additional IST patients.

- *Planning Funds for Secure Treatment Bed Expansion.* Provides $1.9 million General Fund for planning activities related to a project at Metropolitan State Hospital that would increase secure IST bed capacity by approximately 200, while also adding 32 skilled nursing beds. The Administration estimates total project costs of $32 million and annual staffing costs of $48 million.

The Administration reports that it has not yet determined why the number of IST referrals is increasing, though the DSH and the Department of Developmental Services are working to do so. Without knowing whether the trend is long term, it will be difficult to determine the best solution. Capital outlay might not be the best approach, especially if there are short-term or one-time factors driving the increase and the resulting backlog. Before finalizing any capital outlay expenditure plans, the Administration needs to report to the Legislature on the factors that are causing increased IST referrals.

On the other hand, failure to address the backlog in a timely manner could be costly. DSH is currently facing legal pressure from local agencies to either accept new referrals faster or pay the costs of housing those defendants in local jails. The worst of both worlds could occur if the courts were to order DSH to increase capacity <u>and</u> pay housing costs for backlogged inmates in the meantime. It is incumbent upon the Administration to expeditiously determine the root cause of the swelling backlog and identify cost-effective solutions to address it for inclusion in the May Revision. This problem has dragged on far too long.

Judiciary

Increased Funding for the Trial Courts. Between 2008-09 and 2012-13, annual General Fund support for the trial courts was reduced by about $724 million. Actions were taken to mitigate the negative impact of these reductions on court operations, including increasing court user fees, shifting court construction funds to operational purposes, and tapping trial court reserves. While these measures may have softened the blow of the funding reductions, many courts were still forced to implement cost-reducing measures, including furloughs and layoffs of court employees, reductions in court services, and closures of courtrooms or entire courthouses to live within their budgets.

The Legislature began to restore trial court funding in 2013-14 by increasing General Fund support by $60 million. The 2014 Budget Act added another $129 million General Fund, and the 2015-16 Governor's Budget proposes an additional $180 million General Fund, as follows:

- ***Baseline Funding –*** $90.1 million to provide a five-percent increase to baseline trial court operational funding.

- ***Salary and Benefit Costs –*** $42.7 million to fund increasing employee and retiree benefit costs. This is part of a multi-year plan to encourage the trial courts to comply with standards set forth in the Public Employees' Pension Reform Act of 2013 (PEPRA) that require state employees to share in their retirement costs. The plan, which commenced in 2014-15, funds increased retirement and employee health care costs one year in arrears, to the extent the courts make satisfactory progress (by the Administration's standards) toward complying with PEPRA. The Administration indicates that some courts have begun to make progress toward this goal. While this initial success is encouraging, other indicators point out the need for continued scrutiny. In a report released on January 7, 2015, the Bureau of State Audits (BSA) pointed out that the Judicial Council continues to pay the employee's share of retirement costs for some of its executive-level staff.[10] If the agency responsible for oversight of the trial courts does not comply with PEPRA, it seems unlikely the trial courts themselves will comply. More pressure may be necessary.

- ***Proposition 47 Workload –*** $26.9 million for new workload to process petitions and hold resentencing hearings following the passage of Proposition 47 in the November 2014 General Election. Proposition 47 retroactively changed the definitions of certain drug and property crimes, transforming many crimes that were previously felonies or wobblers into misdemeanors. It also authorized offenders convicted of those crimes to petition the court for resentencing under the new definitions. The courts are experiencing significant workload increases to resentence offenders currently in custody and to change felony convictions to misdemeanors for offenders who have already served their time and been released.

- ***Making Temporary Fee Increases Permanent –*** $19.8 million to backfill court user fee revenue that is coming in below projections. In addition, the Governor is proposing to permanently extend various temporary court user fee increases that were enacted in the 2012 Budget Act. These fee increases, which generate annual revenues to the Trial Court Trust Fund (TCTF) of approximately $38 million, are set to expire at the end of 2014-15. Other temporary fee increases, totaling approximately $8.9 million in annual TCTF revenues, are set to expire on either July 1, 2017 or January 1, 2019. User fees create barriers to justice for many would-be litigants. Since 2009-10, more than $120 million in court costs that used to be

[10] Bureau of State Audits, Report 2014-107. *Judicial Branch of California: Because of Questionable Fiscal and Operational Decisions, the Judicial Council and the Administrative Office of the Courts Have Not Maximized the Funds Available for the Courts.*

supported by the General Fund have been passed on to court users in the form of new or increased user fees. As evidenced by the $19.8 million revenue shortfall, many court users are either unable or are opting not to pay these fees, meaning their grievances are either going unresolved or being addressed outside the court system. The Governor is on the right track in backfilling the revenue shortfall to keep trial court funding whole. However, his proposal to make these onerous, if temporary, fees permanent is misguided. A better plan – one that would actually improve access to justice for the poor and the middle class – would be to let the fee increases expire and increase General Fund support to the trial courts to make up the difference.

Judicial Branch Needs Accountability. While the trial courts have certainly felt the impact of reduced funding, it is worth noting that there is always room for improvement and that the courts, like all governmental entities, have a responsibility to serve the public in the most efficient manner possible. The trial courts are not exempt from the requirement to continually examine themselves in search of better ways to do their business. Opportunities for improvement are readily available, including streamlining the process for the collection of court-ordered debt, automating archaic court reporting and case filing processes, reducing wasted court time by improving and expanding services for self-represented litigants, and streamlining the legal process for certain case types by increasing the use of specialized courts.

Example One: Court-Ordered Debt Collection Process. A recent report by the Legislative Analyst's Office (LAO) suggested that the process for collecting court-ordered debt (mostly fines and their associated fees, penalties, and assessments) could be improved significantly.[11] The report concluded that, due in large part to a lack of fiscal incentives for the courts to collect unpaid debt, a staggering $10.2 billion in court-ordered debt remained outstanding at the end of 2011-12. **According to the most recent Judicial Council report on the collection of court-ordered debt, the amount of outstanding debt decreased to $9.1 billion by the end of 2013-14. It is still a stunning amount, however.** The LAO recommends restructuring the process to provide adequate fiscal incentives to the courts to focus their efforts on cost effective debt collection. Improving the collection of court-ordered debt could yield two primary benefits. First, it should enhance respect for the law and improve its deterrent effect because these monetary penalties are part of the debt to society that is owed by criminals and scofflaws. Conversely, failing to collect them reduces their deterrent effect, since, in many cases, they are the only punishment imposed. Second, done properly, the additional revenues from improved collection efforts could exceed the increased costs, resulting in additional revenues for the trial courts and potentially more revenue for counties and other state agencies that receive shares of court-ordered debt.

Example Two: Stabilizing the State Penalty Fund. One consequence of failing to collect court-ordered debt is that the State Penalty Fund is negatively impacted. A large portion of the state's share of these collections is deposited in the State Penalty Fund, which is distributed formulaically to support various state and local programs. When these debts go uncollected, funding is not available for the programs that depend on the State Penalty Fund. **These programs include support for victim-witnesses as they testify at trial, training for local public prosecutors and public defenders, and training for peace officers and correctional officers.**

Over the past six years, revenues to the State Penalty Fund have declined significantly. Absent corrective action, the Administration indicates that two funds that receive revenues from the State Penalty Fund, namely the Peace Officers' Training Fund (POTF) and the Corrections Training Fund (CTF), will become insolvent in 2015-16. The POTF is the sole funding source for the Commission on Peace Officer Standards and Training (POST), the state agency responsible for developing peace officer policies, best practices, and training for state and local law enforcement agencies throughout

[11] Legislative Analyst's Office. *Restructuring the Court-Ordered Debt Collection Process*. November 10, 2014.

California. The Governor proposes a two-pronged temporary solution to address the immediate problem facing the POTF. First, he plans to extend a temporary reduction in funding for POST's state administrative costs through 2015-16. This will provide savings of approximately $5.3 million. Second, he proposes an 18-month debt amnesty program whereby individuals with past-due court-ordered debt from convictions for traffic infractions and select misdemeanors would be able to extinguish their debt by paying 50 percent of it within the amnesty period. The additional revenues to the State Penalty Fund would be used to prop up the POTF and the CTF while the Administration looks for ways to correct the long-term insolvency issue.

The insolvency of these funds has been a long time in the making. The Governor should have done more before now to address the problem. Amnesty programs can be effective at increasing revenues in the short term. However, they may also cannibalize longer-term revenues. Additionally, used too frequently, they may actually encourage people to not pay their debts and simply "wait it out" until the next amnesty opportunity. The most recent amnesty period was from July 1, 2011 through December 31, 2011. Implementing another amnesty opportunity so soon after the last one could send the wrong message. The Administration should look for other ways to address the immediate problem, such as providing General Fund support for these programs until a permanent solution can be implemented.

Example Three: Administrative Office of the Courts Lacks Accountability. The trial courts are not the only member of the Judicial Branch family that needs improved accountability. According to the aforementioned BSA report, the Judicial Council's hands-off treatment of its staff in the Administrative Office of the Courts (AOC) has led to questionable fiscal and operational decisions by the AOC. Specifically, the report concludes that **the AOC provides overly generous compensation and benefits to its staff, uses contracts and questionable accounting practices to circumvent the budget process and shift state operations costs to the trial courts, and maintains a fleet of vehicles without adequate recordkeeping or justification for their need.** The report also points out that while the AOC provides 272 different services to the trial courts, it has never surveyed the trial courts to assess their needs, which would allow it to better align the services it provides with demand for those services. Of the 272 services provided, 124 are used by less than 50 percent of trial courts and an astounding 39 services are used by less than 25 percent of trial courts.

Transportation

It Appears the Governor Wants New Taxes or Fees for Transportation. The Governor's budget provides $10.5 billion to the Department of Transportation for various programs including transportation infrastructure. The main sources of funding come from federal funds, state taxes on fuels, vehicle weight fees, and the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Proposition 1B). In addition, $1.4 billion from fuel excise taxes is allocated to cities and counties for local streets and roads. Even with the billions of dollars directed to transportation, the Administration indicates that there exists a $6 billion unfunded annual need to adequately maintain and repair state highways.

According to the Administration, $11.5 billion in ongoing transportation revenues are available for the state's transportation infrastructure, but approximately 70 percent goes to local streets and roads, transit, debt service, and capacity expansions. As a result, the Administration indicates that the state's highway system has deteriorated. Furthermore, the Governor has acknowledged that the requirements (regulations) that California has placed on reducing fuel consumption and increasing electric vehicles numbers have led to a reduction in long-term fuel excise tax revenues, which are the state's primary source of funding for maintenance and repair of its transportation infrastructure.

Therefore, the Governor believes California needs to establish new funding sources that would provide the additional $6 billion annually that is needed to fund the gap in the State Highway Operations and Protection Program. However, it appears that the Administration is not interested in new bond funding and is looking toward new programs and financing strategies that provide a pay-as-you-go approach.

- **Charge for Vehicle Miles Traveled.** The Budget proposes to provide $9.4 million in State Highway Account funding to implement the Road Usage Charge Pilot Program (SB 1077 of 2014). This program would explore a mileage-based revenue collection system or Road Usage Charge which could replace the gasoline tax system. The final report is due June 30, 2018. Although this proposal could increase revenues, obstacles still exist that could limit future revenues due to potential constitutional questions and pricing concerns related to having a mileage tracking devise placed on personal vehicles, not to mention resistance from California motorists.

- **New Toll Lanes and Weight Fees.** The Administration is also proposing trailer bill language to convert high-occupancy vehicle lanes to high-occupancy toll lanes and open these lanes to paying drivers. In addition, the Administration discusses the need for additional solutions that could include new local revenue options and expanded weight fees to a new category of vehicle. Although the weight fee expansion is not specific, this would likely include sport utility vehicles.

- **Relinquishment of State Highway Routes.** The Administration is proposing legislation to streamline relinquishments of specific routes that are still part of the state highway system that no longer serve an interregional purpose. This would reduce the state's long-term costs for ongoing maintenance and repair.

Start by Restoring $1 Billion of Diverted Fees. The Governor has proposed some new ideas to increase revenues yet there is no mention of the approximately $1 billion annually being diverted from weight fees to pay debt service. **These monies are supposed to fund highway maintenance and repair projects, but are being diverted to support other spending.** As General Fund revenues have increased, the responsibility for transportation debt service payments should once again be funded with General Fund revenues. Furthermore, a comprehensive analysis needs to be completed to determine why California spends more than twice the national average for transportation infrastructure.

In a Reason Foundation study entitled "Examining U.S. Highway and Bridge Performance Trends from 1989 to 2008," **California ranked last in the country in "overall performance and spending efficiency."** California spent $5.84 per mile on state-administered highways, more than twice the national average, yet California's rural and urban interstates are some of the worst in the country, ranking 48th and 49th respectively. More new taxes and fees will not resolve this ongoing problem.

Governor Breaks Ground on High Speed Rail Project with Legally Questionable Funding Source. The Governor continues to fund his bullet train with a legally questionable funding source and has recently broke ground on the project in Fresno. The 2015-16 proposed budget provides funding of $1.7 billion ($1.2 billion in federal funds, $250 million Cap and Trade revenues, and $224 million Proposition 1A bond funds). Last year's Cap and Trade trailer bill (SB 862) allocated 25 percent of future Cap and Trade revenues, beginning in 2015-16, to the HSR project, giving the Governor a blank check without future votes of the Legislature despite LAO warnings that it is legally risky to link the bullet train to Cap and Trade funds. Furthermore, **the HSR Authority plans to further divert Cap and Trade revenues by using this revenue stream to securitize financing,** likely in the form of a revenue bond, which will require interest payments. The Cap and Trade program was established as a "market-based mechanism" to fund programs that reduce greenhouse gas emissions (GHG) to 1990 levels by 2020. Cap and Trade tax money is supposed to be used for programs that would reduce greenhouse gas emissions in the short term, prior to 2020. As we all know, this project will have no GHG reductions prior to 2020 since the first piece of operational high-speed rail track will not be completed until 2021.

Caltrans' Overstaffing Diverts $500 million from Transportation Projects. The Governor has taken no action to reduce the overstaffing for the Capital Outlay Support Program (COS) program within Caltrans. The COS Program provides the resources necessary to deliver highway capital outlay projects to construction, as well as, administer and oversee projects in construction. The department accomplishes about 90 percent of its COS work with state staff, and about 10 percent of work with private consultants even though Proposition 35, passed by voters in 2000, allows the state to contract for Architectural and Engineering (A&E) services in all situations for public works projects.

Currently the program includes $1.7 billion and 9,894 full-time equivalent (FTE) positions. Last year, the LAO reported that the **COS Program was overstaffed by 3,500 FTEs at a cost of more than $500 million (various non-General Fund sources) annually**. The 2014-15 Budget Act contained language requiring the Department of Transportation to provide data related to its 2015-16 Capital Outlay Support budget request on January 10, 2015. At this time, no budget information has been received. Past practice has been for this information to be provided during May Revision which gave limited legislative review time before the budget was due. As the Governor ignores this problem, he has begun seeking new revenues to help maintain and repair the state highway system. Redirecting the $500 million from COS to road maintenance and repair would be a good first step.

Resources & Environmental Protection

Cap and Trade Program Means Higher Gas Prices for California Families. The Budget Act continues to spend an additional $1 billion of Cap and Trade tax revenues in 2015-16 on programs that do little to reduce Greenhouse Gas Emissions (GHG). **By continuing to remove billions of dollars from our economy, this program will limit job opportunities and increase the cost of living in California, which hurts low and middle income families.** To combat these negative effects, Senate Republicans continue to propose that the "hidden gas tax" be repealed and that any revenues be used on projects that provide significant amounts of GHG reductions while relieving pressure on California businesses. Regrettably, this year's budget proposal continues to use the Cap and Trade taxes irresponsibly.

Cap and Trade Expenditure Plan

(Dollars in Millions)

Category	Department	Program	Amount
Sustainable Communities and Clean Transportation	High-Speed Rail Authority	High-Speed Rail Project	$250
	State Transit Assistance	Low Carbon Transit Operations Program	$50
	Transportation Agency	Transit and Intercity Rail Capital Program	$100
	Strategic Growth Council	Affordable Housing and Sustainable Communities Program	$200
	Air Resources Board	Low Carbon Transportation	$200
Energy Efficiency and Clean Energy	Department of Community Services and Development	Energy Efficiency Upgrades/Weatherization	$75
	California Energy Commission	Energy Efficiency for Public Buildings	$20
	Department of Food and Agriculture	Agricultural Energy and Operational Efficiency	$15
Natural Resources and Waste Diversion	Department of Fish and Wildlife	Wetlands and Watershed Restoration	$25
	Department of Forestry and Fire Protection	Fire Prevention and Urban Forestry Projects	$42
	CalRecycle	Waste Diversion	$25
Total			**$1,002**

At this point, the California Air Resources Board still has no metrics in place to evaluate GHG reductions. The Governor uses Cap and Trade tax revenues to fund the High Speed Rail (HSR) project *(see Transportation section, Page 36),* which does <u>not</u> meet the requirements of reducing GHG emissions since the project would actually increase GHG significantly during construction. This budget proposal is largely a continuation of last year's programs that have no clear nexus to GHG reductions, which supports the argument that the **Cap and Trade fee is actually an illegal tax.** The California Chamber of Commerce is currently litigating over this program on the grounds that it is a tax that was approved with only a majority vote. The litigation is currently at the Court of Appeals.

California families and businesses will feel more financial pain as refiners are now responsible for 'tailpipe' GHG emissions from cars and trucks (i.e. fuels under the cap). This means that transportation and natural gas sold into the state will be charged a Cap and Trade tax at the wholesale level. This cost will be passed along to consumers at the pump. Many have called this the "hidden gas tax." According to studies by the Drivers Alliance and Market Stimulation Group, the potential impact that the Cap and Trade tax will have on the cost of fuel is that gasoline will increase by 10 cents per gallon in 2015 and 12 cents per gallon by 2020. However, there is a strong possibility that the price impact may be as high as 37 cents per gallon in 2015 and 47 cents per gallon by 2020.

Currently, the impact of fuels coming under the "cap" has been somewhat muted due to the fact that the price of oil continues to drop drastically. That said, California drivers are incurring the extra cost. The impact of the hidden gas tax is more evident when looking at the average cost of gasoline nationwide. While Californians always pay more than the national average, they are now paying even more due to the cost of this additional tax. For example, Californians historically pay roughly $0.35 more per gallon than the national average. **But today Californians are paying roughly $0.45 more than the national average.** Specifically, the national average is $2.18 while the average cost in California is $2.63. Some states are seeing even lower costs of fuel. For example, the average cost for a gallon of gas in Texas is now $1.95, while folks in Missouri are enjoying a statewide average gas price of $1.82 per gallon.

To date, the ARB has held nine auctions which have generated $988 million in state revenues. In addition, $1.4 billion has also been generated for investor owned utilities and public owned utilities with the revenues to be used as directed by the California Public Utilities Commission or governing boards for ratepayer benefits pursuant to AB 32. To fund the 2015-16 budget proposal, an additional $886 million will need to be produced from future Cap and Trade auctions.

The Cap and Trade budget trailer bill (SB 862 of 2014) designated how future Cap and Trade revenues would be spent. After 2014-15, it provides 60 percent continuously appropriated for transit, affordable housing, sustainable communities, and High Speed Rail. The remaining 40 percent will be annually appropriated in the budget or legislation for low carbon transportation, natural resources programs, energy programs, and other programs.

Governor's Sketchy Climate Change Plan. Although information is limited, the Governor wants to work with the Legislature and stakeholders to develop a midterm reduction target for 2030 that would eventually reduce GHG emissions by 80 percent below 1990 levels by 2050.

This reduction plan would include the following strategies:

- Decarbonizing electricity
- Energy efficiency for existing buildings
- Cleaner transportation fuels and reduced vehicle miles traveled *(this area would receive 50 of future Cap and Trade revenues)*
- Water and space heating
- Natural and working lands
- Short-lived climate pollutants
- Price on carbon
- Resilience

Though these strategies to reduce GHG emissions are vague, one thing is clear; **the cost to low and middle income Californian's will be severe since California has one of the highest residential energy rates in the nation**, **and the second highest commercial rate**.

California Water Action Plan Expenditures. The budget proposes to spend $1.7 billion to implement the Water Action Plan that the Governor released in January 2014. This funding consists of approximately $533 million from the Water Quality, Supply, and Infrastructure Improvement Act of 2014 (Proposition 1 (See chart below)), $1.1 billion from the Disaster Preparedness and Flood Prevention Bond Act (Prop 1E), $10 million General Fund, $2.6 million in other funds, and $1.8 million from a Water Rights Fee increase. These funds will be used for activities related to restoration, climate change, reliability, flood protection, groundwater management, in-stream flows, Delta Plan implementation, water management, and safe drinking water for disadvantaged communities.

At this time, no surface storage monies ($2.7 billion continuous appropriation in Prop 1) have been allocated for water storage projects. This money will be distributed by the California Water Commission pursuant to regulations associated with the quantification and management of public benefits and specific project criteria. These regulations must be completed by December 15, 2016 and no funding may be allocated until that date. Senate Republicans believe this funding is vital to provide much needed new water supply to Californians, and continue to focus on getting this funding allocated as soon as possible.

2015-16 Proposition 1 (Water Bond) Expenditure Plan

(Dollars in Millions)

Category	Department	Program	Amount
Safe Drinking Water	State Water Resources Control Board	Wastewater Treatment Projects	$66.3
	State Water Resources Control Board	Safe Drinking Water in Small Disadvantaged Communities	$69.2
Watershed Protection and Restoration	State Conservancies	Watershed Projects	$83.5
	Wildlife Conservation Board	Ehanced Stream Flow Projects	$38.9
	Santa Monica and San Gabriel Conservancies	Urban Rivers and Creeks	$19.1
	Department of Fish and Wildlife	Watershed Restoration Projects (Non-Delta and In-Delta)	$36.5
Regional Water Reliability	Department of Water Resources	Integrated Rgional Water Management Program	$32.8
	Department of Water Resources	Water Conservation	$23.2
	State Water Resources Control Board	Stormwater Management	$0.6
Water Storage	Department of Water Resources	Statewide Water System Operational Improvement	$3.3
Water Recycling	Department of Water Resources	Water Recycling and Desalination	$5.5
	State Water Resources Control Board	Water Recycling and Treatment Technology Projects	$131.7
Groundwater Sustainability	Department of Water Resources	Groundwater Management Planning	$21.3
	State Water Resources Control Board	Groundwater Contamination	$0.6
Total			**$532.5**

Emergency Drought Response Funding. The 2015-16 Budget Act provides $115 million ($93.5 million General Fund and $21.5 million other funds) on a one-time basis to continue drought response activities should drought conditions continue this year. The funding would be allocated as follows:

- $59.4 million General Fund and $2.4 million other funds to the Department of Forestry and Fire Protection for firefighting and fire prevention activities.
- $11.4 million General Fund and $3.2 million other funds to the Department of Fish and Wildlife to continue fish rescues, hatchery operations, and fish and wildlife monitoring.
- $11.6 million General Fund to the Department of Water Resources to access current surface and groundwater conditions, expedite water transfers, provide guidance to local water agencies, and provide additional public outreach.
- $7 million General Fund (carryover) to the Department of Social Services to provide food assistance for communities most impacted by the drought.
- $6.7 million General Fund and $15.9 million other funds to the State Water Resources Control Board to continue the enforcement of drought-related water rights and water curtailment actions and grants for emergency drinking water programs.
- $4.4 million General Fund to the Office of Emergency Services for the State Operations Center to continue to provide local communities with disaster recovery support.

Governor Reduces Payment In Lieu of Taxes (PILT) Owed to Counties. The budget proposes to spend $644,000 in 2015-16 to provide payments to counties in lieu of taxes to compensate for tax revenue that was lost due to private property converting to state-owned. These payments, made by the Department of Fish and Wildlife for wildlife management areas, were paid until the 2002 Budget Act eliminated them to achieve General Fund savings. The amount budgeted is significantly less than the $1.6 million that counties believe is owed for the 2014-15 fiscal year. According to the Department of Finance (DOF), counties allocate a percentage of their property taxes to school districts pursuant to AB 8 (Chapter 282, Statutes of 1979) which established requirements for local property tax allocations. Based on the percentage of property taxes that each county allocated, DOF reduced the PILT payment stating that Proposition 98 already funded that portion. Therefore, the PILT payments were reduced by $908,000 for the 2014-15 fiscal year. Furthermore, the Administration has not provided any funding to address the unpaid past PILT payments which totals $18.6 million (includes the $1.6 million for 2014-15). The Administration also plans on submitting trailer bill language that would make PILT funding discretionary and prohibits counties from applying PILT funding to school districts. This may be unlawful and certainly dishonorable given that PILT payments were agreed to at the time the lands transferred to state ownership. This proposal could result in less wildlife management areas as counties will be unwilling to support this program. At this time, counties are still determining the merits of the proposal since the Administration did not reach out to stakeholders before the payments were recalculated.

New California Drinking Water Program Fee Increases. Senate Republicans were right to be concerned about last year's transfer of the Safe Drinking Water Program from the Department of Public Health to the State Water Resources Control Board (SWRCB). The budget shifted $200 million in funding and transferred 291.5 positions, and made numerous statutory changes (SB 861, Resources Trailer Bill, of 2014) to move the administration of the Safe Drinking Water Program to SWRCB. At that time, it was unclear whether this transfer would provide a better drinking water program or simply reorganize existing cubicles with little overall improvements to the program. Since the SWRCB had been known for its burdensome regulations and excessive fees on the agricultural industry, water rights holders, and property owners the transfer was viewed with caution and concern as it was a huge policy issue that should have received much more public scrutiny. ***Less than six months later, the SWRCB is requesting emergency regulations that allow the Board to administratively adopt an annual fee schedule to align revenues with expenditures to support the Safe Drinking Water Program.*** These emergency regulations and any subsequent annual fee increases will not be subject to approval by the Office of Administrative Law. This will make the fee schedule similar to the Water Rights and Water Quality Fee programs which have seen millions of dollars in annual increases without any legislative oversight.

General Fund for California Fairs and Laboratory Network. The budget provides $3.1 million General Fund ongoing to assist with fair operations, improve the financial stability of smaller fairs statewide, and provide funding to support additional fair board training. General Fund support was eliminated for California fairs in 2011, and since that time many fairs have experienced fiscal hardship and are at risk of closing. The budget also includes one-time funding of $7 million General Fund for deferred maintenance at California fairs. The Governor's budget also proposes an additional $4.3 million General Fund for the California Animal Health and Food Safety Laboratory Network and to meet the operational needs of the new South Valley Animal Health Laboratory in Tulare.

CAL FIRE Helicopter Replacement. The department will be undertaking a competitive replacement process for its fleet of 12 aging Vietnam-era helicopters. At this time, there is no funding contained in the budget just a request for budget bill language specifying that CAL FIRE and the Department of General Services shall work together on a procurement and contract for the helicopter replacements. The department anticipates a budget request to be submitted to the Legislature in May of 2016 when an actual cost per aircraft will be known. Although no funding has been requested, the cost of the aircraft replacement could be in the hundreds of millions of dollars.

More Funding to Continue Existing Service Levels at State Parks. The Administration proposes a one-time appropriation of $16.8 million from the State Parks and Recreation Fund in 2015-16 to maintain existing park service levels throughout the state park system. The 2014-15 budget also contains a one-time appropriation of $14 million for this same purpose. If approved by the Legislature, the department will also receive $20 million General Fund for critical infrastructure and deferred maintenance needs at the parks.

General Funding Continues to Help Enforce Environmental Laws Associated with Marijuana Cultivation. The Budget proposes $1.5 million from General Fund for the State Water Resources Control Board to continue a pilot project approved in 2014-15 to help address damage occurring to the state's natural resources resulting from marijuana cultivation on public and private lands in California.

Labor and Workforce Development

Employment Development Department (EDD)

Unemployment Insurance Loan Repayment. The Governor's Budget includes $184.4 million General Fund to pay interest due to the federal government in September 2015 for an Unemployment Fund loan secured to pay Unemployment Insurance (UI) benefits. The UI fund began incurring this debt in January 2009 at the height of the “great recession. In October 2014 the EDD reported that, "The UI Fund deficit was $9.7 billion at the end of 2013. The deficit is projected at $8.7 billion at the end of 2014, $7.4 billion by the end of 2015, and $5.5 billion by the end of 2016 if changes are not made to the financing structure.” In September 2015, California will make its fifth interest payment on this loan (for a total of about $1.3 billion), and will continue to pay interest until the UI loan is fully repaid.

September Payment	Amount	Fund
2011	$303.5 million	Disability Insurance Fund
2012	$308.3 million	Disability Insurance Fund
2013	$259.0 million	General Fund
2014	$217.4 million	General Fund
2015	$184.4 million	General Fund
Total	**$1,272.5 million**	

California borrowed $611.7 million from the State Disability Insurance Fund to make the first two interest payments (September 2011 and September 2012). As part of the Proposition 2 Rainy Day Fund debt reduction plan, the Governor’s budget includes $303.5 million General Fund in 2015-16 and $308.3 million General Fund in 2016-17 to pay back the loans from the Disability Insurance Fund.

Absent any corrective actions, EDD projects that the federal loan will be fully repaid by 2020. In the interim, **the federal government is ratcheting up federal employment taxes (by 0.3 percent each year; it is currently up 1.5 percent for 2015)** to pay down the principal on the federal loan. As a result, California employers are paying higher and higher unemployment insurance taxes each year, as reflected in the following table (EDD estimates).

Year	Tax Increase	Impact on Employers
2011	0.3 percent	
2012	0.6 percent	$292.7 million
2013	0.9 percent	$601.0 million
2014	1.2 percent	$945.2 million
2015	1.5 percent	$1.3 billion

In this case, a lack of action by the Governor and legislative Democrats equates to a backdoor **tax increase on employers**. Nothing would prohibit the General Fund from making payments to accelerate repayment of the federal loan, which would help employers avoid higher UI taxes as the economy improves.

Unemployment Insurance (UI) Administration. The federal government (which is responsible for funding UI administration) is providing less federal funding each year, and the state has to pick up the balance. According to EDD, the federal government will only provide about 77 percent ($342.3 million) of what its own Resource Justification Model calculates California should receive in 2015 ($446.3 million). Instead of pushing the federal government to fully fund its share of UI administration, the Governor’s budget includes $39 million General Fund in 2015 16 (including $21.7 million carried over from prior years) to fund the shortfall. This is in addition to the following, cobbled-together list of solutions meant to provide administration resources for 2014-15:

- $64 million General Fund appropriation.
- $104.4 million of transfers and appropriations from a variety of other related special funds.

- $79.2 million of unused federal carryover funds.
- $52.2 million of "efficiencies" intended to allow the department to do more with less.
- $15.9 million related to suspending (for one year) the quarterly transfer of penalties and interest from the EDD Contingent Fund to the General Fund.
- $12.7 million of one-time revenue related to the sale of a building in Hollywood.
- $10.1 million related to increasing withholding and reporting penalties on employers.

This is not a perfect solution, but it will get California by for the current and budget years. Until the federal government acts to fully fund UI administration based on what its own Resource Justification Model calculates California should receive, this issue will be revisited every four to six months to make sure that EDD is able to maintain its customer service efforts.

Employment Training Panel (ETP). The Governor's budget includes $10 million Employment Training Fund (Fund) in 2015-16, which is projected to provide $26.3 million in contracting capacity (approximately 145 training contracts) to serve approximately 23,000 additional employees. This is in addition to the one-time $10 million augmentation provided in the 2014 Budget Act. ETP's core program is funded by the Employment Training Tax, which California employers participating in the UI system pay to promote the development of their workers. Employers train their own employees to perform new or higher-level jobs and then apply to ETP for training cost reimbursements when employees meet certain achievement requirements.

Workforce Investment Act (WIA) Funding. The budget includes an increase of $15.4 million federal funds in 2014-15 for the Governor's WIA discretionary funding and Rapid Response funding due to an increase in discretionary funds from 5 percent to 8.75 percent of the federal allotment. This augmentation includes the creation of the *SlingShot Regional Grants* program and the expansion of *Regional Workforce Accelerator Program Grants* (both are components of the Governor's workforce training consolidation plan) to address regional barriers to employment. Additional changes to WIA funding levels are expected after federal guidelines for the new Workforce Act are released in early 2015.

Department of Industrial Relations

Elevator Inspections and Inspection Fee Reduction. The budget includes an increase of $4.4 million Elevator Safety Account to meet annual inspection requirements for approximately 108,000 conveyances throughout the state. **Due to the account's surplus, the Budget also proposes a fee holiday for routine elevator inspections and an ongoing reduction in the inspection fee.** This may be the first time in the last decade that government fees have decreased instead of increased.

Local Government

Redevelopment Agencies

With the elimination of RDAs the state established "successor agencies" to ensure the timely retirement of outstanding RDA debts and other legal obligations, and the move resulted in property tax dollars being redirected back to cities, counties, special districts, and K−14 schools. According to the Department of Finance, while billions of dollars are being retained by successor agencies to retire debts and other legal obligations, billions of dollars are also flowing back to local governments and schools, as reflected in the following table:

Dollars in Millions	Total to be Allocated	Schools	Cities	Counties	Special Districts
2011-12 & 2012-13	$4,057.3	$2,252.6	$619.8	$875.1	$309.9
2013-14	$2,169.4	$1,229.1	$374.4	$444.0	$122.0
2014-15 Estimate	$1,556.1	$890.9	$270.3	$302.5	$92.4
2015-16 Estimate	$1,832.4	$1,049.1	$317.2	$354.7	$111.4
2016-17 Estimate	$2,181.7	$1,250.3	$376.5	$423.1	$131.8
2017-18 Estimate	$2,725.8	$1,562.4	$462.5	$528.5	$172.4

Source: Department of Finance

On an ongoing basis, Proposition 98 General Fund savings are estimated to exceed $1 billion annually, and it is estimated that additional ongoing property tax revenues of more than $800 million annually will be distributed to cities, counties, and special districts.

Simplifying Dissolution Process. Now that the dissolution of redevelopment agencies is in its fifth year, the Governor plans to propose legislation to simplify the ongoing administrative process and gradually transition the state away from the current detailed role in the RDA dissolution process. Successor agencies would be transitioned from a biannual process for approving Recognized Obligation Payment Schedules (ROPS) to an annual ROPS process beginning July 1, 2016. This annual process would be available only to successor agencies that have a Finding of Completion, are in agreement with Finance on what items qualify for payment, and meet other specified conditions. Once approved by Finance, a "Last and Final" ROPS would be binding on all parties and the successor agency will no longer submit a ROPS to Finance or the oversight board. The county auditor-controller would remit funds each year until each remaining enforceable obligation has been fully paid.

In 2011 many Republicans opposed the elimination of RDAs because, despite the many anecdotes of abuses, there were also many success stories of cities statewide using this tool to improve transportation infrastructure, provide affordable housing, and revitalize town centers. Over the past two years, there have been numerous attempts to pass legislation that would provide for exemptions or solutions to fix "problems" resulting from the "one-size-fits-all" elimination of RDAs, and the Governor has consistently vetoed all of those bills that made it to his desk. With a revised process in place, the Governor may be more willing now to work with individual districts to solve district-specific dissolution problems.

State Mandated Local Programs

Pre-2004 Mandate Reimbursements. As of November 2014, after paying $100 million in early 2014-15, the state still owes about $719.2 million to cities ($163.1 million), counties ($557.7 million) and special districts ($6.7 million) for unpaid mandate reimbursement claims that had accumulated prior to the passage of Proposition 1A of 2004. Under current law, these amounts must be repaid by 2020-21. The 2014 Budget Act includes a trigger mechanism that will be used if, at the 2015 May Revision, estimated General Fund revenues for the 2013-14 and 2014-15 fiscal years exceed the 2014 May Revision estimate for those same revenues. After satisfying the Proposition 98 guarantee, additional revenues, up to $800 million, will pay down the remainder of the state's pre-2004 mandate debt. **Current estimates indicate that the trigger mechanism will result in a $533 million payment toward this mandate debt.**
Even though the final calculation for reimbursement will not occur until the 2015-16 May Revision, $533 million is a good place to start as reimbursement of these costs is critical for local governments.

Election-Related Mandates. Last year Senate Republicans fought to include $100 million General Fund to reimburse counties for accumulated costs for nine election-related mandates and to reactivate those election-related mandates for 2014-15. Funding for these mandates continues to be an important issue because, as stated by the Legislative Analyst's Office, "Suspending elections mandates poses a significant risk to state elections. We believe that the administration's proposal to suspend the mandates represents the worst option as it carries with it the largest risk for inconsistencies in California elections."

The California Voter Foundation also opposed the suspensions stating that "Failure to fund state mandated election programs could lead to election challenges. Imagine what might happen in statewide or legislative contests if counties within the same political district have different vote-by-mail practices. Contests would go undecided for days and weeks, litigation and court battles would ensue, and results would be called into question." Senate Republicans continue to believe that the state must fund these mandates to ensure fair, uniform, and transparent elections statewide.

Funded/Suspended Mandates. The Governor's budget provides $9.6 million General Fund (one-time) to pay back costs that local governments incurred between 2001 and 2013 for performing activities under the Public Records Act (the PRA is no longer a state-mandated program as it was placed in the Constitution by the voters via Proposition 42 in June 2014) and $218,000 General Fund to fund the Accounting for Local Revenue Realignment mandate that involves county administration of funding changes in 2003-2004 that addressed budget shortfalls at that time.

With those exceptions, the Governor's budget continues to suspend more than 60 mandates not related to property taxes or public safety. This includes the newly adopted Interagency Child Abuse and Neglect Investigation Reports mandate, which is estimated to have cost local governments $90.3 million from 1999 to 2011. Senate Republicans have concerns about how mandate suspensions create confusion at the county level (which mandates are active versus suspended) and could lead to inconsistent treatment of voters living in different counties.

Retirement

California State Teachers' Retirement System (CalSTRS)

New Plan to Address Liabilities Included in 2014 Budget. The 2015-16 Governor's Budget includes $1.9 billion General Fund for CalSTRS, an increase of $442 million General Fund and 30 percent above the 2014-15 Budget, with **total 2015-16 contributions to CalSTRS projected to be about $9 billion** from all three funding sources (school districts, teachers, and the state). The 2014 budget included a new funding plan for the California State Teachers' Retirement System (CalSTRS) intended to address the largest unfunded fiscal liability facing the state at $74 billion, with contribution increases phased in over the next few years for schools, teachers and the state. By 2020-21 the contribution increases will be fully phased in and state contributions will be about $2.5 billion General Fund, up from $1.4 billion General Fund in 2014-15 when proposal was included in the budget, and **funding from all three sources would be $13 billion and growing.**

California Public Employees Retirement System (CalPERS)

Public Employee Pension Costs Continue to Rise. The 2015-16 Governor's Budget includes $5 billion ($2.9 billion General Fund) for contributions to CalPERS for retirement costs of state employees, including California State University employees. This is a 10 percent increase over 2014-15 ($448 million). In two years, the state's costs for pensions have increased by $865 million, or 42 percent. Contributions are projected to reach $5.7 billion ($3.3 billion General Fund) in 2017-18, a 51 percent increase in costs since 2013-14 Additionally, although the cost increases projected for the next few years are startling, the future cost to taxpayers could actually be much higher if market returns are lower than the projected. The 7.5 percent return assumed by CalPERS is considered by many experts to be unrealistically high, and could lead the state to underestimate future General Fund pension costs.

Pension Reform Savings Modestly Reduce Unfunded Liability. The Governor's Budget includes savings as a result of the passage of AB 340- Public Employees' Pension Reform Act of 2013 (PEPRA). PEPRA provided lower pension benefits, required higher retirement ages, and also required higher contributions from state employees. The 2015-16 budget includes savings of $106.6 million ($73.8 million General Fund) as a result of PEPRA, and the entire amount is required to be contributed to the state's unfunded pension liability, estimated to be $50 billion as of June 30, 2015.

Retiree Health Care Benefits

The 2015-16 Governor's Budget includes $4.8 billion ($3.0 billion General Fund) for health care benefits for more than 800,000 state employees, retirees, and their family members. Of the $4.8 billion, $1.9 billion General Fund is for state retiree health care benefits in 2015-16, an increase of $1.5 billion compared to costs for retiree health care benefits in 2001-02.

Unfunded Liabilities for Retiree Health Generally Ignored For Years . Unlike California's pension plan, retiree health benefits are not prefunded, and instead are paid for in the year the benefits are used by the retirees, referred to as a "pay-as-you-go" approach. This means that the medical costs of retirees (and their dependents) are paid from current revenues as the benefits are provided, not from funds set aside during the working life of that retiree.

Unfortunately, the pay-as-you-go approach has led to the accumulation of massive financial liabilities, estimated to be nearly $72 billion as of June 30, 2013, an increase of more than $24 billion, or 33 percent above the first actuarial assessment completed in 2007 by the State Controller's Office. Unchecked, the unfunded liability would likely exceed $92 billion in five years, crowding out other spending priorities, like education and public safety, and limiting the state's ability to access the capital markets to finance the projected $66 billion in deferred maintenance on existing state infrastructure.

Governor Punts to Unions. The Governor's 2015-16 budget includes principles to address the state's $72 billion retiree health care unfunded liability but does not propose new spending in 2015-16. Instead, the Governor is counting on unions to step up and concede more money out of the pockets of state employees. However, bargaining always includes concessions on both sides, and in the past, any additional employee contributions are almost always offset by salary increases, meaning that one way or the other the taxpayers will pick up the tab.

Governor's Plan May Not Truly Address $72 billion Unfunded Liability. The Governor's principles call for additional contributions to be part of future bargaining unit agreements, with the state seeking equal sharing in the prefunding of the "normal cost" of retiree health care (similar to the new pension-funding standard approved as part of pension reform in 2012). **Upon full implementation, the additional state contributions will increase costs by about $600 million ($285 million General Fund) annually**.

Prospectively funding "normal costs" should stop the growth in retiree health unfunded liabilities. **However, the Governor has not explained how his plan will reduce the current $72 billion problem.**

In addition to cost sharing with state employees, the Governor's plan also calls for the following changes to begin to address the growth of state health care benefit costs:

- Requires CalPERS to offer a high deductible health plan, with the Administration proposing to provide contributions to an employee's Health Savings Account to defray higher out-of-pocket expenses.
- Pursue changes to lower the state's premium subsidy, currently based on a formula using the average premiums of the four highest enrolled plans as a way to encourage employees to select lower-cost plans.
- Increase time newly hired employees must work for full vesting of health care benefits from 10-20 years to 15-25 years. Additionally, the Governor's plan would reduce the state's contribution for retirees from the current 100/90 percent to what they received during their working years (either 80/80 percent or 85/80 percent). This could result in significant General Fund savings but not in the short term

- Governor proposes to implement unknown measures to increase transparency of state health care benefit expenses, with the goal being increased public discussion and legislative engagement.

The Governor's approach appears to be consistent with prior Senate Republican proposals, although the devil is always in the details. We must hope that a plan can be negotiated with unions that will truly reduce the unfunded health care liability while curtailing the growth of health care costs.

History of Retiree Health Benefits. Current law provides state contributions for retiree health benefits on the basis of a "100/90 formula." Under the formula, the state's contributions are equal to 100 percent of the average retiree health premium, and 90 percent of dependent costs. The formula applies to all eligible retirees, including those from the California State University system. The state has not always paid 100 percent of the retiree's health benefits. In fact, up until 1978, the state only paid 80 percent of both employee and retiree health benefits, and 60 percent of dependent costs. The chart below provides a timeline of retiree health benefit event milestones:

Year	Event
1961	State contributions of $5 per month begin.
1967	Local agencies begin contracting with CalPERS for health benefits.
1974	State pays 80 percent of employee/retiree and 60 percent of dependent costs.
1978	State pays 100 percent of employee/retiree and 90 percent of dependent costs.
1984	State costs exceed $100 million. Legislature increases years required for employees to vest in retiree health benefits, from 100 percent at five years to 50 percent at 10 years and 100 percent of premium costs at 20 years of service.
1991	State begins to pay less than 100/90 formula for current employees (either 80/80 or 85/80 depending on the bargaining unit agreement in effect), however, the 100/90 formula continues for retirees.
2006	The 2006-07 Budget Act includes costs of approximately $1.4 billion General Fund for retiree health care costs.

Changes to Retiree Health Subsidies. In 1991, the state missed an opportunity to reduce the potential fiscal impact of providing retiree health benefits when it failed to reduce the state's 100/90 percent participation rate for retiree health care at the same time the rate was reduced (down to 80/80 or 85/80 percent) for current employees. In fact, during the working years of current employees, they and their family members usually receive health benefits under the 80/80 or 85/80 state contribution formulas included in collective bargaining agreements. After retirement, the new retirees and their families typically receive benefits under the more generous 100/90 formula**. Upon retirement, the employees actually experience a reduction in premium costs, with the state contributing an increased share.** The Governor's proposed plan would revise the state's subsidy for newly hired employees, consistent with what they received during their working years.

Statewide Debts & Liabilities

Payment in Governor's budget. The Governor's budget proposes to repay about $4.2 billion of debts and liabilities by the end of the 2015-16 fiscal year, as follows:

- An estimated $533 million will be paid to cities, counties and special districts by the end of the current year to reimburse them for costs incurred prior to 2004 for state-mandated programs. This payment would be made pursuant to "trigger" language included in the 2014 Budget Act, and will likely change in May 2015 with the Administration's updated revenue estimates for the May Revision.
- Approximately $1 billion will be returned to K-12 schools in the current year to unwind deferrals that were employed during the recession as budget solutions. This unwinding of deferrals is also tied to the "trigger" language discussed above.
- Approximately $965 million General Fund will be used in 2015-16 to repay special fund loans, which were used in prior years to solve General Fund budget deficits. This payment counts toward the Proposition 2 (2014) requirement that a portion of General Fund revenues be used to pay down certain wall-of-debt obligations.
- Approximately $256 million General Fund will be used in 2015-16 to settle-up prior year "underfunding" of Proposition 98 obligations, which is also consistent with Proposition 2's debt repayment requirements.
- General Funds of approximately $1.3 billion in 2014-15 and $200 million in 2015-16 will used to repay costs incurred by schools to comply with various education mandates, which were previously identified on the Governor's wall of debt.

Proposition 2 Liabilities. The Governor's budget also identifies an addition $227 billion of liabilities facing the state in the coming years, including outstanding budgetary borrowing and state retirement liabilities. The following table represents only those liabilities that are identified and mandated for repayment from General Fund revenues pursuant to Proposition 2 (see Page 7 for details regarding the Rainy Day Fund).

Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2
(Dollars in Millions)

	At Start of 2015-16	Proposed Use of Proposition 2 Funds				Remaining Liabilities
		2015-16	2016-17	2017-18	2018-19	
Budgetary Borrowing						
Loans from Special Funds	$3,028	$965	$1,123	$694	$246	$0
Underfunding of Proposition 98—Settle-Up	1,512	256	0	445	811	$0
Unpaid Mandate Claims for Local Governments (prior to 2004-05) - After CY trigger payment of $533 million	257	0	0	0	0	$257
State Retirement Liabilities						
State Retiree Health	71,773	0	0	0	0	N/A
State Employee Pensions	49,978	0	0	0	0	N/A
Teacher Pensions (state portion = $19.9 billion)	74,374	0	0	0	0	N/A
Judges' Pensions	3,371	0	0	0	0	N/A
Deferred payments to CalPERS	530	0	0	0	0	N/A
University of California Retirement Liabilities						
University of California Employee Pensions	7,633	0	0	0	0	N/A
University of California Retiree Health	14,519	0	0	0	0	N/A
Totals	**$226,975**	**$1,221**	**$1,123**	**$1,139**	**$1,057**	**$257**

Missing in Action – Wall of Debt Liabilities. For each of the past three years, the Governor has attempted to consolidate and quantify outstanding state budgetary debts, as well as progress towards reducing those obligations, by using what he termed as the "wall of debt." With the passage of Proposition 2 this past November, the Department of Finance (Finance) has abandoned the wall of debt table in exchange for a "Debts and Liabilities Eligible for Accelerated Payments under Proposition 2" table (previous page). In doing so, the Governor's budget fails to recognize about $7.8 billion of debts that are no longer being captured as part of the big-picture debt overview. The following table reflects the amount of debt obligations that had previously been included on the wall of debt, but are not included on the new schedule of debt obligations.

Remaining Wall of Debt Obligations Not Included in Governor's Budget
(Dollars in Millions)

	Outstanding Amount at Start of 2015-16	2015-16 Impact	2016-17 Impact	2017-18 Impact	2018-19 Impact	Remaining Amount Not Currently Scheduled
Unpaid Mandate Costs to Schools and Community Colleges	$4,220	$196	$0	$401	$730	$2,893
Deferred Medi-Cal Costs	2,324	0	0	0	0	2,324
Deferral of State Payroll Costs from June to July	783	0	0	0	0	783
Defferred Payments to CalPERS	411	0	0	0	0	411
Borrowing from Transportation Funds (Proposition 42)	84	0	0	0	0	84
Totals	**$7,822**	**$196**	**$0**	**$401**	**$730**	**$6,495**

Finance indicates that it is assuming school mandates will be paid with "settle-up" funds, but that repayment of the deferred Medi-Cal, state payroll costs, PERS deferrals and the repayment of borrowing from Proposition 42 transportation funds will not occur during the multi-year projection window (so, presumably it occurs after 2018-19).

Unemployment Insurance (UI) Debt. In order to pay all eligible unemployment insurance claims during the "great recession," the UI fund began incurring debt (a loan from the federal government) in January 2009. In October 2014 the Employment Development Department (EDD) reported that, "The UI Fund deficit was $9.7 billion at the end of 2013. **The deficit is projected at $8.7 billion at the end of 2014,** $7.4 billion by the end of 2015, and $5.5 billion by the end of 2016 if changes are not made to the financing structure."

Long-Term Infrastructure Debt. In addition to the debts and liabilities discussed above, there is little fanfare for the $79 billion of General Obligation (GO) debt and $11.2 billion of Lease Revenue (LR) debt that the state already owes to investors. The Governor's budget assumes General Fund payments of about $5.3 billion in 2014-15 and $5.6 billion in 2015-16 to service the state's GO debt, as well as $928.3 million in 2014-15 and $997.3 million in 2015-16 to service the state's LR debt (a majority of which is General Fund supported).

Additionally, the state has the authority to issue approximately $31.1 billion of GO debt to investors that has been "authorized, but not issued" to date. This includes the $7.5 billion of GO debt recently authorized by voters this past November (Proposition 1 of 2014). While it is likely that the state will not issue all of this debt at once, over time the issuance of this debt will drive up annual debt service costs. The Governor's budget projects that approximately $3.6 billion of additional GO debt will be issued during 2015, including $52.9 million pursuant to Proposition 1 for the purpose of drought relief.

Appendix A - California's Tax Rankings

California is a great state to live and work. The state's climate, weather and quality of life are the envy of the country. California leads the nation with its cutting edge high-tech and biotech industries and has a rich and vibrant agriculture industry. It also has large markets, its ports are the gateway to and from Asia and it has a large pool of skilled labor.

For all of California's benefits, it has some significant drawbacks. For the privilege of living, working or operating a business in the state, Californians are required to pay some of the highest personal income, sales and corporate taxes in the nation, and are subjected to unnecessarily burdensome and overly complex laws and regulations.

According to *Dun & Bradstreet*, **2,565 California businesses with three or more employees have relocated to other states between January 2007 and 2011, and 109,000 jobs left with those employers**.[12]

Over the last decade, California has consistently placed at or near the bottom of many national business climate and tax rankings, which compare the business climates of the nation's 50 states.

CEO Magazine, in its 2014 annual survey of more than 500 CEOs, ranked California as the worst state to do business for tenth year in a row. Keep in mind that they have conducted the survey for only ten years.[13] One CEO commented, "California could hardly do more to discourage business if that was the goal. The regulatory, tax and political environment are crushing." *CEO Magazine* also cites an *Economist* report that "it takes two years to open a new restaurant in the Golden State compared to six to eight weeks in Texas. The task of unraveling the byzantine layers of regulations seems insurmountable."[14]

Forbes Magazine rated California as being the 37th worst state for business (up from #41 last year). Its report is based on based on six factors: business costs, labor supply, regulatory environment, economic climate, growth prospects and quality of life.[15]

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[12] "Open Letter to California Air Resources Board," Southern California Leadership Council, October 25, 2010, pp. 1, 4, http://www.laedc.org/sclc/documents/Global_102510_CARB.pdf

[13] Chief Executive Magazine, 2014 Best & Worst States for Business. http://chiefexecutive.net/2014-best-worst-states-for-business

[14] Chief Executive Magazine, 2014 Best & Worst States for Business. http://chiefexecutive.net/2014-best-worst-states-for-business

[15] Forbes Magazine, "Utah is Top Spot for Business," published November 11, 2014. http://forbes.com/best-states-for-business

According to the Tax Foundation's 2015 *State Business Tax Climate Index,*[16] California has the third worst business tax climate in the nation, behind only New York and New Jersey (see table below). *This **Index rates a state's tax systems*** based on individual income tax, corporate tax, sales tax, and property tax.

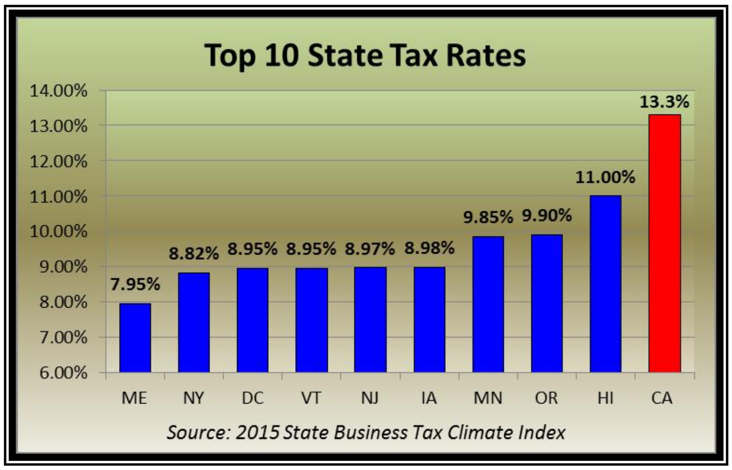
State	Overall Rank	Corporate Tax Rank	Personal Income Tax Rank	Sales Tax Rank	Property Tax Rank
California	48	34	50	42	14
New York	49	20	49	40	46
New Jersey	50	41	48	48	50

The following pages will dissect a portion of the state's overall tax structure, and provide a comparison of how California compares to other states in terms of the state's major tax rates.

Personal Income Tax: Highest in the Nation

California has the highest marginal tax rate and one of the most progressive personal income tax systems in the nation.

Comparing marginal tax rates, before the passage of Proposition 30 in November 2012, California had the second highest marginal personal income tax rate in the nation. Proposition 30 pushed personal income tax rates even higher, increasing taxes on those making $250,000 or more. The state's top marginal rate is now 13.3 percent for all personal income taxpayers with taxable income over $1 million (this includes the 1 percent surcharge for mental health programs under Proposition 63 of 2004). Hawaii ranks second with a top tax rate 11 percent, which kicks in at $200,000. Seven states do not impose a personal income tax (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming).



In terms of tax system progressivity, where a small number of higher-income taxpayers pay a larger share of their incomes in taxes, California has one of the most progressive tax systems in the nation. In 2010, the Pacific Research Institute rated California 48 out of 50 on the progressivity of its tax structure, behind only Hawaii and New Jersey.[17] In 2012, California's tax structure got even more progressive when Proposition 30 created three new tax brackets for the highest income earners. In the 2012 tax year, more than 15.9 million returns were filed with the California Franchise Tax Board (all classifications). California taxpayers with an adjusted gross income (AGI) greater than $200,000 accounted for about 5.1 percent of the total tax returns filed (five percent in 2011), but paid 70.6 percent of the taxes collected (62.8 percent in 2011). Taxpayers with an AGI greater than $400,000 (top 1.5 percent) account for about 55.2 percent of the taxes collected, compared to only 44.9 percent in 2011.

[16] Tax Foundation, "2015 State Business Tax Climate Index," published October 28, 2014. http://taxfoundation.org/tax-topics/state-business-tax-climate-index

[17] Pacific Research Institute – Taxifornia: California's tax system, comparisons to other states, and the path to reform in the Golden State. By Robert P. Murphy, PH.D., and Jason Clemens. March 2010

	2011 Tax Year			2012 Tax Year		
Adjusted Gross Income	**Returns**	**% of Returns**	**Tax Liability**	**Returns**	**% of Returns**	**Tax Liability**
No Taxes Paid	6,809,308	43.0%	0.0%	6,602,248	41.5%	0.0%
Less and $50,000	3,505,813	22.2%	3.2%	3,720,761	23.4%	2.5%
$50,000 to $100,000	2,935,144	18.5%	11.8%	2,961,011	18.6%	9.2%
$100,000 to $200,000	1,792,778	11.3%	22.2%	1,822,451	11.4%	17.6%
$200,000 to $400,000	530,854	3.4%	17.8%	574,460	3.6%	15.4%
More than $400,000	250,587	1.6%	44.9%	241,071	1.5%	55.2%
	15,824,484			**15,922,002**		

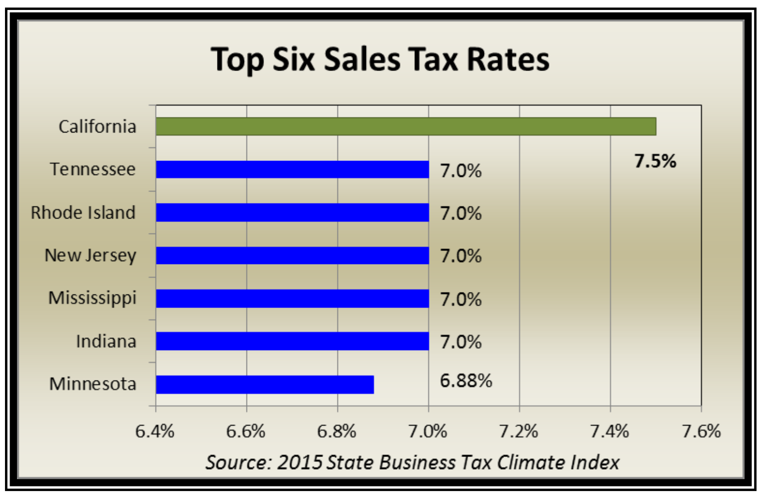
Source: FTB 2011 and 2012 Annual Reports

Also note that 41.5 percent of returns filed (about 6.6 million) either did not have a tax liability or received a full refund of wage withholding. These numbers do not include (a) employees who did not file a return because they did not meet the minimum requirements to do so, and (b) the "scofflaws" who are required to file a return but did not.

State Sales and Use Tax: Highest in the Nation

California imposes a 7.5 percent statewide sales and use tax on the purchase or use of tangible personal property, which is the highest statewide rate in the nation. This rate includes Proposition 30's quarter cent sales tax increase, which is effective through December 31, 2016. Even though California made huge strides last year when it exempted manufacturing equipment from the state portion of the sales tax, the state slipped from number 41 to number 42 in the *Business Tax Climate Index*.[18]

With one exception, **city and county voters may also elect to increase the sales tax rate by up to two percent** to fund activities within their localities. The exception is Los Angeles County, which may increase the sales tax rate by 2.5 percent.

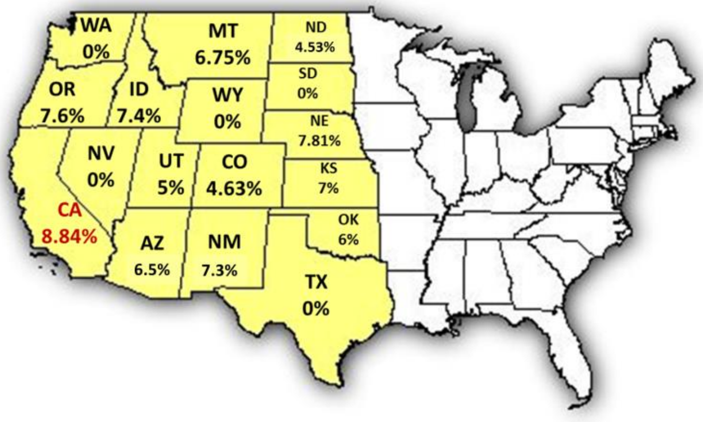


Three counties have a rate of 9 percent (Alameda, Los Angeles, and San Mateo). Forty four cities impose sales taxes at or above nine percent, including **three cities in Los Angeles County that tax its citizens at 10 percent** (La Mirada, Pico Rivera, and South Gate). Statewide, however, the average (including local add-ons) is closer to 8.45 percent. The table above shows how California compares to the next six highest statewide sales tax rates. Four states do not impose any state or local sales taxes (Delaware, Montana, New Hampshire, and Oregon).

[18] Tax Foundation, "2015 State Business Tax Climate Index," published October 28, 2014. http://taxfoundation.org/tax-topics/state-business-tax-climate-index

Corporations Tax: Highest in the West

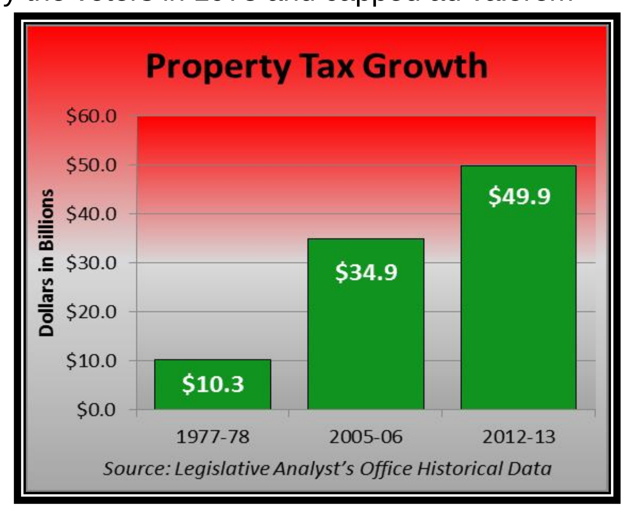
California's has the eleventh highest tax rate in the nation at 8.84 percent levied on all corporate income. Only ten states have higher rates (Alaska, Connecticut, Illinois, Iowa, Maine, Minnesota, New Jersey, Pennsylvania, Rhode Island and District of Columbia). Iowa levies the highest tax rate at 12 percent, but that rate only applies to incomes over $250,000. Comparing state's that levy flat rates (every dollar earned is taxed the same), California has the 7th highest of the 50 states, and the highest rate in the western United States (see graphic on next page). Three states do not impose a corporation tax, and three others impose an alternative gross receipts tax in lieu of a corporation tax.



Data Source: 2015 State Business Tax Climate Index

Property Tax: More Favorable, Thanks to Proposition 13

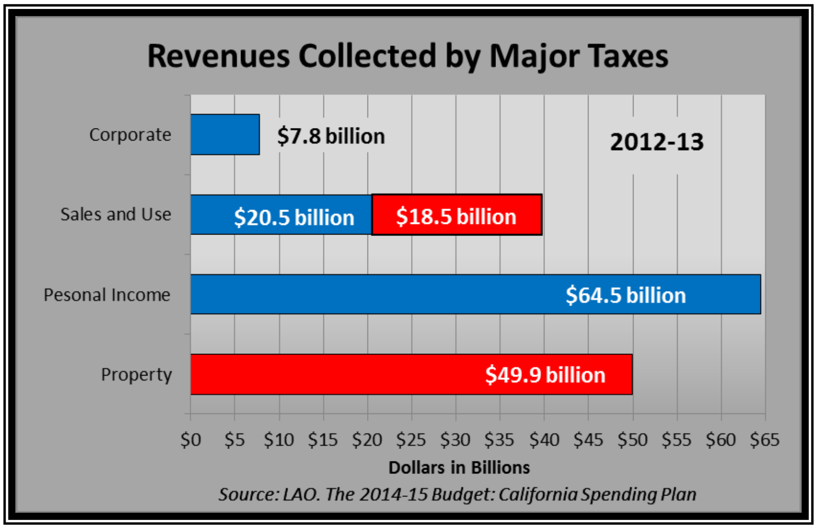
Thanks primarily to Proposition 13, which was passed by the voters in 1978 and capped ad valorem property taxes at one percent of assessed value, California ranks number 14 out of 50 states under the *2015 State Business Tax Climate Index*. Notwithstanding the protections commercial and residential property owners receive under Proposition 13, as of July 1, 2014 property taxes in California equated to $1,426 per capita, ranking California as 20th highest in the nation.[19]



Even though voters capped ad valorem taxes in 1977-78, the amount of revenue generated by that tax has seen a meteoric increase. When property taxes were cut in 1977-78, the state in aggregate collected about $10.3 billion of property taxes. As property values increased over the past four decades, so have property tax collections. Total aggregate property tax revenues reached $34.9 billion in 2005-06, and are estimated to reach $49.9 billion in 2012-13.[20]

[19] Tax Foundation, "2015 State Business Tax Climate Index," published October 28, 2014. http://taxfoundation.org/tax-topics/state-business-tax-climate-index

[20] Data provided by Legislative Analyst's Office, "CalFacts," published in December 2014. http://www.lao.ca.gov/reports/2014/calfacts/calfacts-2014.pdf

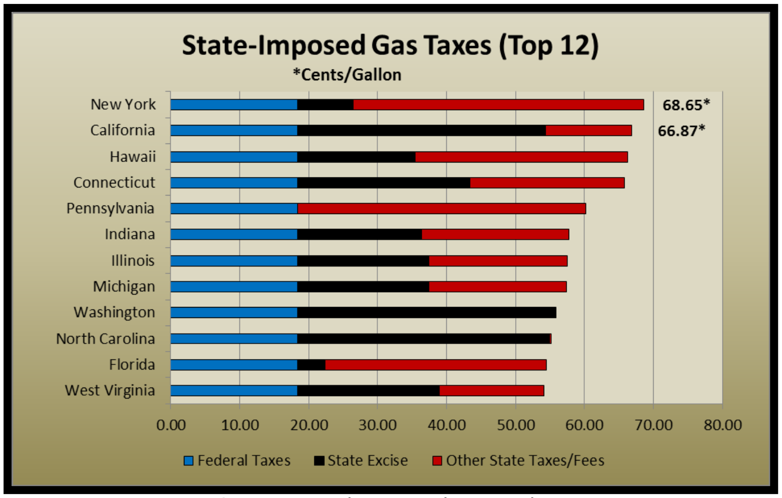


As a source of tax revenue, property taxes are the second largest source of tax revenue behind personal income taxes, which accounted for $64.5 billion in 2012-13 and **accounts for more tax revenue than the state's sales and use tax and corporate income tax combined.**

Note: The blue bars represent General Fund revenues, while the red bar represents local revenues. If you add the local share of revenues generated by the state sales tax (not including local add-ons), the total state sales tax generates about $39 billion.

Gasoline Tax: Second Highest in the Nation

Federal government collects 18.4 cents on ever gallon sold in the United States. In addition, states levy their own sales, use and excise taxes, as well as other taxes and fees. According to the American Petroleum Institute, California imposes the second highest state gasoline taxes on consumers in the nation at 48.47 cents per gallon (behind only New York at 50.25 cents/gallon). Combined with the federal gas taxes, California taxpayers pay 66.87 cents for every gallon to the government, nearly two cents less per gallon than taxpayers in New York.[21] The following chart compares the level of gas taxes imposed by the top 12 highest taxing states.



Source: American Petroleum Institute

Not included in this table is the anticipated increase to gasoline prices that will result from including transportation and natural gas fuel suppliers under the umbrella of the Cap-and-Trade program (as part of the California Global Warming Solutions Act/AB 32). Transportation and natural gas sold into the California will be charged a cap-and-trade tax at the wholesale level. This **"hidden gas tax"** will be passed along to California's consumers at the pump, but will not be captured as part of per gallon tax data. While some researchers have estimated gas prices could increase by as much as 75 cents per

[21] Oil & Natural Gas Overview, "2014 State Motor Fuel Reports," updated October 1, 2014. http://www.api.org/~/media/files/statistics/state-motor-fuel-taxes-report-October-2014.pdf

gallon, a recent study by Justin L. Adams, Ph.D., conducted for the California Driver's Alliance, estimates that gas prices could increase anywhere from 10 cents to 47 cents per gallon.[22]

Conclusion:

If past and present policies are any indication of future actions, California will remain a high-tax state for the foreseeable future. With the burdensome government laws and regulations, it has become increasingly difficult for businesses to deliver products and services in this state in a cost-effective manner. As businesses decide to leave the state or expand outside of California there will be an ever-decreasing number of good paying jobs and a general lack of opportunities for all Californians. Evidence of California's utter disregard for the state's job creators comes from another CEO cited in *Chief Executive Magazine*, who said, "We relocated our corporate offices from Los Angeles to Atlanta in 2006 largely because of the regulatory and unfriendly tax environment in the state of California. We considered Dallas, but settled on Atlanta for customer-related and other secondary or marginal reasons. Would make the same decision if I had to do it all over again."[23] Unless and until California's policymakers take action to change, California will continue to be perceived as having a hostile business climate.

For additional information regarding this tax structure comparison update, call Joe Shinstock or Scott Chavez in the Senate Republican Fiscal Office at (916) 651-1501.

[22] "Placing Fuels Under the Cap: The Economic Impact to California," by Justin L. Adams, Ph.D. September 2014 http://www.californiadriversalliance.org/wp-content/uploads/2014/09/ResourcesFUTC-Economic-Impact-Report.pdf

[23] Chief Executive Magazine, 2014 Best & Worst States for Business. http://chiefexecutive.net/2014-best-worst-states-for-business

Appendix B - California Safety Net Facts

California has a very generous safety net relative to other states. The following statistics, which include the sources of information, provide a remarkable picture of just how robust California's government safety net programs really are.

Welfare

- California has the 5th highest CalWORKs grant in the nation, 2nd highest amongst the ten largest states. (Per Legislative Analyst Office)
- California is only one of three states that provide a grant for the family after the adult has timed out of the CalWORKs program. (Per Legislative Analyst Office)
- About one in five CalWORKs families has received welfare assistance for over six years. (Public Policy Institute of California). (Per Legislative Analyst Office)
- Approximately 50 percent of welfare caseload has less than 12 years of education and the state has no requirement for completion. (Per Legislative Analyst Office)
- California is one of only five states that provide state-funded food assistance to immigrants ineligible for the federal food stamp program. (Per Legislative Analyst Office)
- California is one of only six states that provide a 100 percent state-funded monthly cash benefit to aged, blind and disabled non-citizens who are ineligible for Supplemental Security Income/State Supplementary Payment (SSI/SSP). (Per Legislative Analyst Office)
- California has 12 percent of the nation's population but 33 percent of the welfare caseload (U.S. Department of Health and Human Services, Administration for Children and Families).
- About 70 percent of In-Home Supportive Service recipients receive care from a family member (per the Department of Social Services).

Health

- California is tied for 3rd highest for Medicaid eligibility for childless adults and 4th highest for parents following implementation of health reform. (Per the Kaiser Family Foundation as of August 2014; data available here).
- California is one of 15 total states that provides full Medicaid coverage at state-only cost to legal resident immigrants (those here for less than five years, who are not eligible for federal funds for full-scope coverage). Of the 10 largest states, CA is one of four that provides this coverage (Data per 2011 Urban Institute report).
- California ranks 21st overall, and **4th among the 10 most populous states**, in terms of most generous Medicaid/CHIP eligibility at 266 percent of the federal poverty level. (Data per Kaiser Family Foundation, effective April 2014, available here).

Child Care

California provides some of the most generous child care funding in the nation (per 2014 federal Child Care & Development Fund Policies Database Book of Tables):

- California's family income eligibility limits are higher than most other states (only 10 are higher).

- California's provider rates are among the highest in the nation (6^{th} highest for infant care and 7^{th} highest for pre-school care).

Student Financial Aid

California provides some of the most generous student financial aid in the nation (per 2014 survey by Nat'l Association of State Student Grant & Aid Programs):

- California spends far more *money* on need-based grants than any other state (over $1.5 billion – the next highest is New York at $941 million).

- California makes the second highest *number* of need-based grants (about 261,000 versus New York's 305,000).

- California's *average expenditure per recipient* is the highest in the country by far ($5,826 – New York is $3,049).

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