Highlights and Analysis of the Governor's 2015-16 May Revision

May 18, 2015
SENATE REPUBLICAN FISCAL OFFICE

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Budget Briefs

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Executive Summary

Senate Republicans have long prioritized investing in education as a top priority along with building the state's new rainy day reserve, paying off state budgetary debts, and addressing unfunded liabilities that jeopardize our state's fiscal future. The Governor's May Revision is generally consistent with these priorities as it keeps faith with voter approved constitutional spending requirements for schools and community colleges under Proposition 98 (1988), and higher budget reserve and debt payment requirements under Proposition 2 (2014).

Specifically, the budget plan builds the rainy day reserve to almost $3.5 billion (*see Proposition 2 Rainy Day Fund Page* 6), pays off about $7.9 billion of past budgetary debts (*see Statewide Debts and Liabilities Page 38),* increases funding for K-14 education programs by $7.6 billion compared to the 2014 Budget Act, and provides $430 million more funding for higher education with a tuition freeze at California state colleges and universities that was first introduced by Republicans in 2013 in the form of SB 58 (Cannella, R– Ceres) (*see Education Page 19)*.

While there are many positive aspects to the new budget plan it is, unfortunately, only precariously balanced as it proposes a **new record high spending level of over $267 billion**. This exceeds the 2014 Budget Act total spending ($254 billion) by over $13 billion. State General Fund spending accounts for more than half of the increase, growing by $7 billion from $108 billion last year to over $115 billion for 2015-16. This rapid state spending increase will not be sustainable for very long.

In fact, while the state budget appears to be balanced in the near term, the Department of Finance projects that under current spending policies, **California will return to operating deficits in excess of $2.5 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 misleading.

Despite the large state spending increase, the Governor is being attacked by members of his own political party and many social welfare interest groups for failing to spend more money on new and expanded social programs. Caring for Californians living in poverty and providing them the supports, tools and opportunity to move out of poverty is vitally important. California already has one of the most generous government safety nets for the poor in the nation and we spend more on social welfare than any other state, but it is not clear that our programs are working very well. **If our safety net system is still failing too many Californians, then it may be time to consider how our programs can be made more effective and beneficial for those who need them rather than simply spending more.**

The Governor has defended himself against calls for more spending by saying: ***"We have to learn from history and not keep repeating the mistakes."*** This is a reference to the last two budget crises (i.e., when the 2001 "Tech Bubble" burst and the 2008 "Housing Bubble" burst), which were triggered by revenue windfalls just like the one the state is currently experiencing. In each of those prior cases the Legislature went on a massive spending spree that was unsustainable, and it led to more than a decade of budget deficits, spending cuts, and tax increases. Republicans agree that we must not make the same mistake with this new revenue surplus.

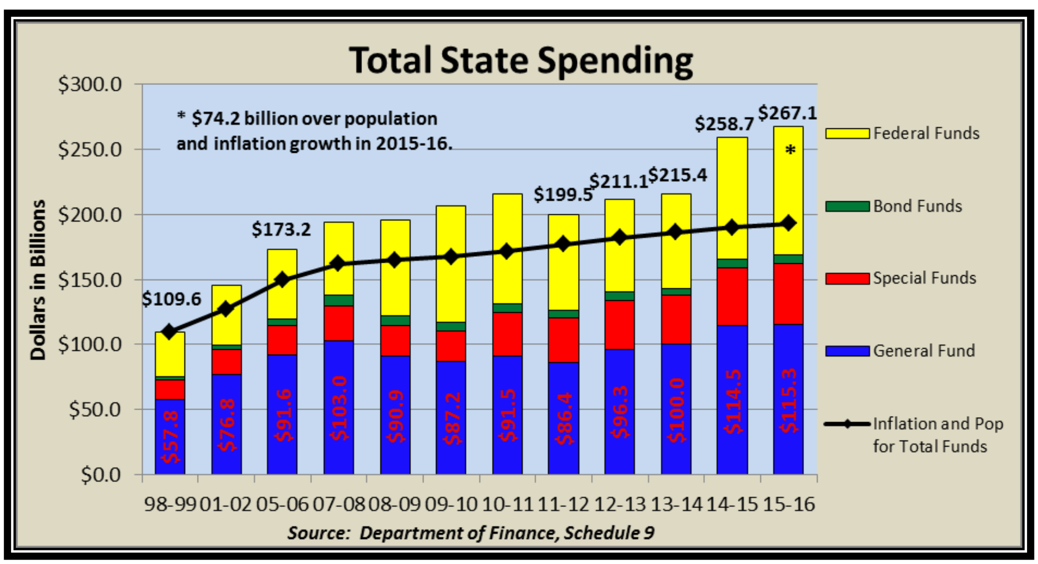
California families deserve responsible government. The most important thing we can do is learn from those past mistakes and make sure we put surplus money into the rainy day fund, debt repayment, and invest one-time funds in infrastructure such as transportation, water, and school projects. Preparing for the future without creating new budget deficits just requires common sense.

Senate Republicans support a smart approach to using one-time surplus revenues that will create job opportunities for struggling families, and provide the foundation for all Californians to have a successful future. By investing in infrastructure projects that fix our roads, increase water supplies, and improve our school buildings, we can create good paying jobs. While the Bay Area and Silicon Valley are thriving, many other parts of our state are still experiencing double-digit unemployment and we have a responsibility to put resources into those communities.

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 spending by billions of dollars poses a serious threat to our state's future**.

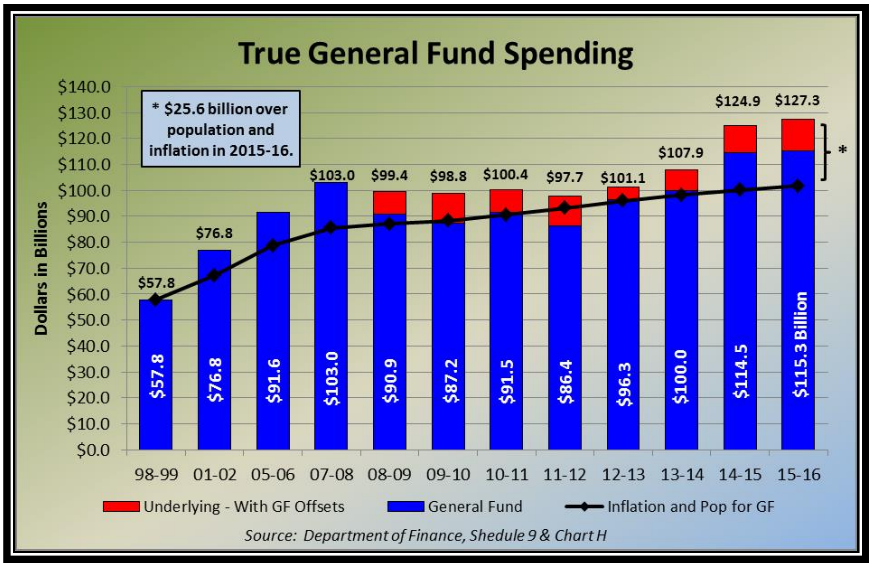
Essential Charts

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 $267 billion, which is $73 billion more than peak spending prior to the Great Recession ($194.3 billion in 2007-08). Despite the Great Recession, and Democrats' claims of "cutting to the bone," total state spending continues to exceed previous record high levels.



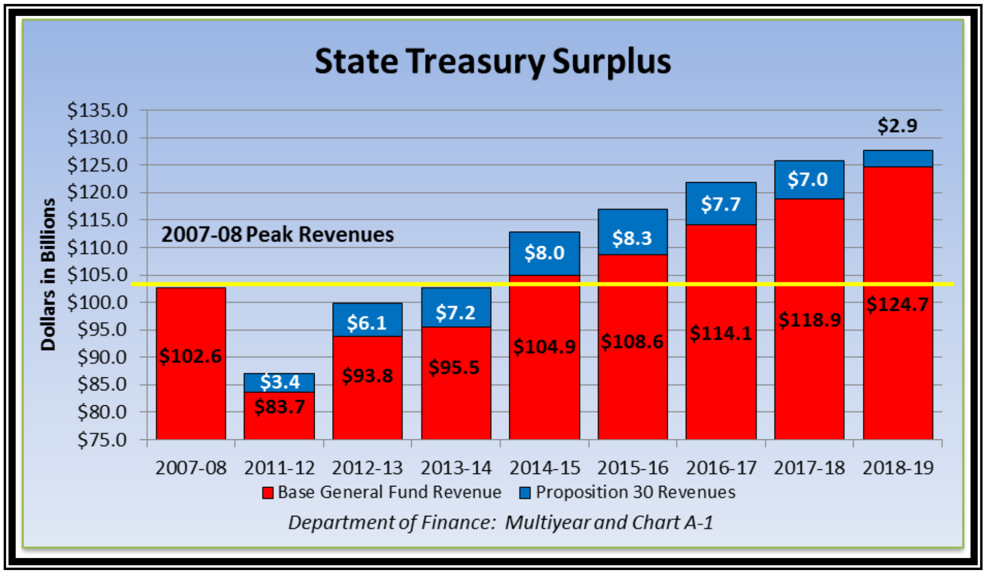
True General Fund Program Spending. Over the past several years, legislative Democrats frequently claimed that state spending had been slashed by $40 billion or more, and that General Fund spending was consistently below its historic peak of $103 billion in 2007-08. In fact, true General Fund program 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:

1) Actual General Fund spending has increased to $115.3 billion in 2015-16 ($12.3 billion more than 2007-08).
2) **True General Fund program spending has increased to $127.3 billion in 2015-16, which is $24.3 billion higher than it was before the great recession.**
3) True General Fund spending is $25.6 billion higher than if state spending had been limited to population and inflation growth since 1998-99, which was the last "stable" state fiscal year prior to the "tech bubble" in 2000 that preceded a decade of budget instability.

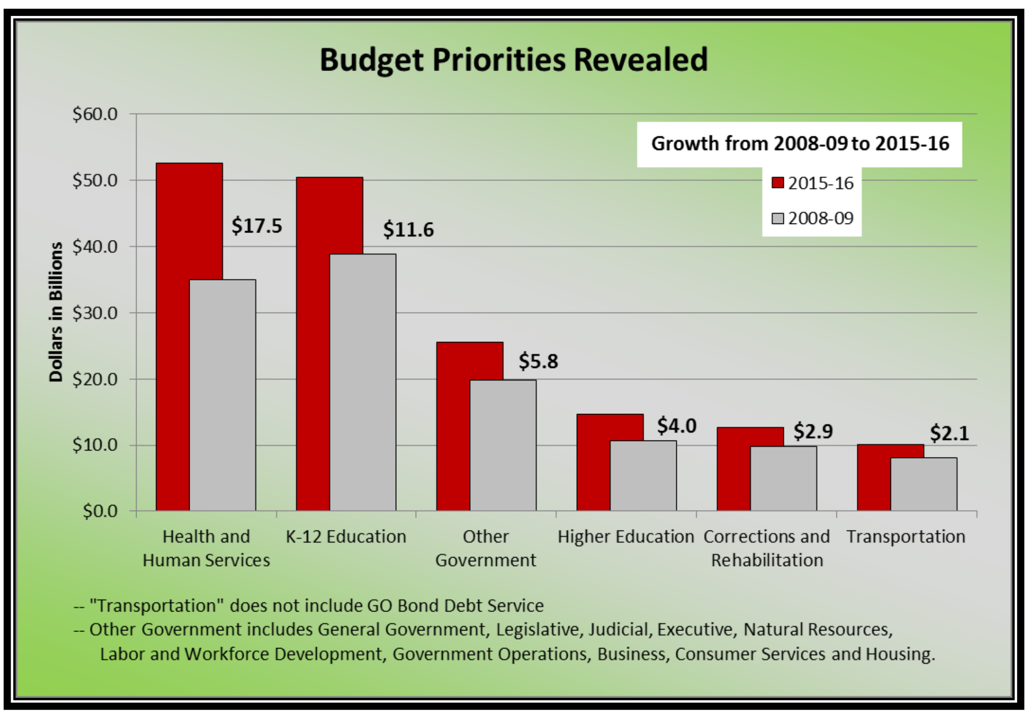


The 2015-16 Governor's Budget includes $12 billion of spending from fund sources other than the General Fund to support traditional General Fund programs, including the $7.2 billion "Realignment," $2.1 billion of Medi-Cal related special taxes and cost shifts, $1.1 billion from the dissolution of redevelopment agencies, $1.2 billion from transportation weight fees to fund debt service, and $534 million of federal Temporary Assistance to Needy Families money to fund CalGrants.

Proposition 30 Tax Increases Not Necessary. Based on Department of Finance projections, even without the tax increases from Proposition 30 (2012), fiscal year 2015-16 baseline state General Fund revenues ($108.6 billion) will eclipse the last tax revenue windfall prior to the Great Recession ($102.6 billion in 2007-08) by $6 billion. Once the Proposition 30 tax increases ($8.3 billion) are added on top of these baseline taxes, 2015-16 General Fund revenues will exceed 2007-08 levels by $14.3 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 $127.6 billion, which is $25 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.**



Transportation Fares Poorly as State Program Funding Grows Dramatically. As state spending continues to rebound strongly in this period of recovery from the recession that began in 2008-09, it is Health and Human Services (HHS) and K-12 programs that are experiencing the greatest benefit. The chart below reflects spending from all state fund sources (i.e., General Fund, Special Funds, and Bond Funds) as it demonstrates that HHS program spending increased by $17.5 billion and K-12 spending grew by $11.6 billion. Combined they account for over $29 billion (66 percent) of the $44 billion in new spending since 2008-09. In contrast, Transportation program funding has fared the worst with an increase of just over $2 billion, which is less than 5 percent of the spending growth. **This is particularly notable in light of the recent discussions regarding the state's crumbling transportation infrastructure and legislative Democrats proposals to raise car and gas taxes by several billion dollars** to address transportation funding shortfalls. Budgets are always a reflection of priorities, but despite all the recent attention, Transportation programs have not received a share of the revenue windfall.



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 May Revision continues to demonstrate Proposition 2's benefit to California by directing an additional $1.2 billion of the state's spiking revenues to the RDF and to debt reduction compared to the January proposal.

Higher Reserves and Debt Reduction. As summarized in the table below, the Governor's May Revision proposes a rainy day transfer of nearly $1.9 billion for the general RDF and another $1.9 billion for debt reduction. These amounts are both $633 million higher than the Governor's January proposals. Over four years these annual transfers are projected to reach $11 billion, including $5.5 billion each for RDF deposits and debt reduction. Notably, nearly $7.4 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 $7.1 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	$1,753	$1,827	$1,888	$1,914	**$7,382**
Capital Gains Taxes in Excess of 8% of General Fund Revenues	$1,955	$1,243	$305	$163	**$3,666**
Rainy Day Amounts Available	**$3,708**	**$3,070**	**$2,193**	**$2,077**	**$11,048**
Debt Repayment (50%)	$1,854	$1,535	$1,097	$1,039	**$5,524**
Deposit to Rainy Day Fund (50%)	$1,854	$1,535	$1,097	$1,039	**$5,524**
Rainy Day Fund Balance at End of Year [1]	**$3,460**	**$4,995**	**$6,092**	**$7,130**	

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, May 2015

Debt Repayment Adjustments. With any constitutional budget formula, there is risk that the ruling party will seek ways to undermine voter intent in favor of its own priorities. The Governor's May Revision makes several key changes compared to the January proposal to meet the higher debt repayment requirement created by the revenue increase:

- ***Increases repayment of special fund loans by $406 million.*** This appears to be a straightforward increase in the number of special fund loans that will be repaid in 2015-16 rather than in later years.
- ***Reduces University of California pension liabilities by $96 million.*** This item is part of an agreement between the University of California (UC) and the Governor in which UC would impose a pension cap consistent with the state's 2012 pension reform law in exchange for temporary assistance in paying down UC's unfunded pension liability. The key concern in this case is whether this repayment is a true addition to UC's reduction of retirement liabilities or whether it replaces existing payments, which would give UC flexibility to spend the $96 million elsewhere. Both the Department of Finance and UC have indicated informally that this amount is intended to be a true additional payment, which would meet the intent of Proposition 2. Senate Republicans will work to ensure that it is genuinely an additional debt payment.

- ***Credits $131 million in January repayments toward Proposition 2.*** As noted by the Legislative Analyst's Office, the May Revision counts two other items as meeting Proposition 2 requirements that were already proposed for payment in January but not "credited" as meeting the Proposition 2 obligation at that time. These items are a $47 million interest payment for special fund loans and repayment of the final $84 million balance of Proposition 42 loans. Counting the interest payment toward the Proposition 2 obligation frees up General Fund that can now be spent elsewhere.

Senate Republicans agree that the Governor's proposals for building the RDF and paying down debt generally meet the requirements of Proposition 2 and enact the will of California voters. There are some technical questions about a couple of the May Revision adjustments, but the Governor's overall Proposition 2 approach in creating a RDF balance of $3.5 billion in 2015-16 reflects the prudence that will be particularly invaluable in the fiscally uncertain years ahead. Senate Republicans will seek to ensure that, as these proposals move through the legislative process, the enacted budget also reflects voters' intention that the state should save for the inevitable next fiscal crisis and pay off debts.

Revenues

Revenue collections over the first four months of 2015 are staggering. The 2015-16 May Revision projects that, since the Governor's Budget was published, General Fund revenues over the three-year forecast window have grown have grown by $6.7 billion. This revised revenue estimate reflects total **General Fund revenues being up by nearly $13.2 billion compared to forecasts prepared for the 2014 Budget Act last June. Notably, General Fund revenues for 2015-16 are about $12.4 billion higher than the pre-recession revenue peak of $102.6 billion in 2007-08.**

After accounting for money being transferred to the Budget Stabilization Account per Proposition 2 of 2014 ($1.6 billion in 2014-15 and $1.9 billion in 2015-16) and decreased revenues attributed to the Governor’s Earned Income Tax Credit proposal (see below), the May Revision estimates total General Fund revenues and transfers to be $9.7 billion higher than the 2014 Budget Act forecast; $111.3 billion in 2014-15, increasing to $115 billion in 2015-16.

Total Revenues and Transfers	Budget Act	May Revision	Forecast Change	%△
2013-14	$102,185	$103,374	$1,189	1.2%
2014-15	$105,489	$111,306	$5,817	5.5%
2015-16	$112,329	$115,033	$2,704	2.4%
Change to Estimate over 3-year Window			$9,710	

Resource: Governor’s Budget Summary

Personal Income Tax (PIT) – The strongest growing revenue source is the PIT, which is estimated to contribute an additional $6.6 billion of revenue to the General Fund. This, plus the $2.3 billion increase identified as part of the Governor's Budget, increases total personal income tax revenues by $8.9 billion since the Budget Act. The Department of Finance (Finance) estimates total personal income tax revenues to $75.4 billion in 2014-15 and $77.7 billion in 2015-16, due to strong withholding growth, partnership income and capital gains.

Personal Income Tax	Budget Act	May Revision	Forecast Change	%△
2013-14	$66,522	$67,025	$503	0.8%
2014-15	$70,238	$75,384	$5,146	7.3%
2015-16	$74,444	$77,700	$3,256	4.4%
Change to Estimate over 3-year Window			$8,905	

Resource: Governor’s Budget Summary

Corporation Tax (CT) – The second strongest growing revenue source is the CT, which is estimated to generate an additional $595 million since the Governor’s Budget ($2.6 billion since the Budget Act). Finance estimates that total CT revenues will reach $9.8 billion in 2014-15 and $10.3 billion in 2015-16, due primarily to higher cash receipts through April 2014.

Corporation Tax	Budget Act	May Revision	Forecast Change	%△
2013-14	$8,107	$9,093	$986	12.2%
2014-15	$8,910	$9,809	$899	10.1%
2015-16	$9,644	$10,342	$698	7.2%
Change to Estimate over 3-year Window			$2,583	

Resource: Governor’s Budget Summary

Sales and Use Tax – In January, Finance estimated that SUT revenues over the three-year forecast would decrease by about $1.4 billion due to a lower growth rate in sales and use tax receipts in 2014. Even though Finance now estimates SUT revenues have strengthened since the Governor's Budget (increasing by $320 million), total SUT revenues are still about $1.1 billion lower than Budget Act estimates.

Sales and Use Tax	Budget Act	May Revision	Forecast Change	%△
2013-14	$22,759	$22,263	-$496	-2.2%
2014-15	$23,823	$23,684	-$139	-0.6%
2015-16	$25,686	$25,240	-$446	-1.7%
Change to Estimate over 3-year Window			**-$1,081**	

Resource: Governor's Budget Summary

According to Finance, SUT revenue growth from 2013-14 to 2014-15 is muted due to a half billion dollar 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.

LAO Revenue Projections Higher than Governor's. Consistent with the last 5 revenue projections, the Legislative Analyst's Office estimates General Fund revenues over the three-year projection window will be significantly higher than the Governor's estimates. For the 2013-14, 2014-15, and 2015-16 fiscal years combined, the LAO main scenario indicates a total of $3.2 billion more General Fund revenues from these three taxes compared to the administration's new projections. This estimate includes a $3.6 billion higher estimate of personal income tax gains, more than half of which are attributed to higher estimates to taxpayers' capital gains. 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 simply increase state spending. It is important to learn from past mistakes, and spending surplus revenues like these has already led California into two budget crises in the past 12 years.

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 $50.5 billion over the eight-year period**).

Proposition 30 Revenue Estimates									
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**Total**
PIT	$3,356	$5,417	$5,813	$6,590	$6,750	$6,834	$7,020	$2,857	$44,637
SUT		$640	$1,384	$1,459	$1,551	$827	$0	$0	$5,861
Total	**$3,356**	**$6,058**	**$7,197**	**$8,049**	**$8,301**	**$7,661**	**$7,020**	**$2,857**	**$50,499**

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.

Earned Income Tax Credit (EITC). The May Revision proposes a state EITC, estimated to decrease revenues by about $380 million annually. The Governor's EITC would be a refundable tax credit for households with income less than $6,580 of wage income if there are no dependents, and up to $13,870 of wage income if there are three or more dependents. The proposed state credit would be targeted to provide a greater benefit per household, and would match 85 percent of the federal credits up to half of the federal phase-in range and then begin to taper off relative to these maximum wage amounts.

This proposal is similar to SB 152 by Senator Vidak (R-Hanford) in that it also attempts to mitigate the problems of the federal EITC related to improper payments. According to the Legislative Analyst's Office, the overpayment percentage on the federal EITC was between 22 percent and 26 percent in federal fiscal year 2013, which would also raise concerns for any state-level EITC.
The Governor's EITC would only be implemented during tax years where the Legislature has appropriated funding for the Franchise Tax Board to oversee and audit returns associated with the credit, and would allow penalties to be assessed on tax preparers "for failure to be diligent in determining eligibility for earned income credit returns."

Expenditures

The 2015-16 May Revision includes revised General Fund expenditures of $114.5 billion in 2014-15 and projected General Fund expenditures of $115.3 billion in 2015-16. In January, the Governor proposed 2015-16 budget that was about $9 billion higher than the 2014 Budget Act. As shown in the table below, General Fund spending in the May Revision grows by another $4.9 billion (since the Governor's Budget). As a result, the following table reflects a year-over-year spending increase of $7.3 billion, with total General Fund spending increasing by nearly $13.9 billion since the 2014 Budget Act.

General Fund Expenditures by Agency

(Dollars in Millions)

Agency	Budget Act 2014-15	Revised 2014-15	Governor's May Revision 2015-16	Year over Year Change
Legislative, Judicial, Executive	$2,968	$3,017	$3,180	$212
Business, Consumer Services, Housing	$850	$843	$623	-$227
Transportation	$216	$200	$261	$45
Natural Resources	$2,260	$2,558	$2,490	$230
Environmental Protection	$63	$87	$65	$2
Health and Human Services	$29,652	$30,046	$31,811	$2,159
Corrections and Rehabilitation	$9,590	$10,030	$10,087	$497
K-12 Education	$44,980	$49,659	$49,285	$4,305
Higher Education	$12,562	$13,267	$14,195	$1,633
Labor and Workforce Development	$303	$282	$215	-$88
Government Operations	$692	$754	$739	$47
General Government/Other	$2,245	$2,188	$2,357	$112
Supplemental ERB Payment	$1,606	$1,606		-$1,606
Total, General Fund Expenditures	**$107,987**	**$114,537**	**$115,308**	**$7,321**
Accumulated spending increase since the Budget Act		$6,550	$7,321	**$13,871**
- As a Percentage		6.1%	6.8%	**12.8%**

Resource: 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, which will be fully repaid in the first quarter of 2015-16.

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 ($46.9 billion), bond funds ($6.8 billion), and federal funds ($98.1 billion) brings total state spending to $267.1 billion for 2015-16. **This level of total state expenditures is $12.7 billion higher than total expenditures in the 2014 Budget Act ($254.4 billion).** By comparison, total state spending proposed for 2015-16 ($267.1 billion) is about $72.8 billion higher than California's last economic peak year prior to the recession ($194.3 billion in 2007-08), and $74.2 billion higher than if state spending had been limited to population and inflation growth since 1998-99, which was the last "stable" year prior to the first recession that resulted from the breaking of the dot-com bubble in 2000. Despite the Great Recession and Democrats' claims of "cutting to the bone," **total state spending continues to break records each year.**

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 $127.3 billion in 2015-16, which is **27.7 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**	**$100.0**	**$114.5**	**$115.3**
"Offsets" to Maintain General Fund Program Levels*	--	$8.5	$11.6	$8.9	$11.3	$4.8	$7.9	$10.4	$12.0
Total, General Fund Program Expenditures	**$103.0**	**$99.4**	**$98.8**	**$100.4**	**$97.7**	**$101.1**	**$107.9**	**$124.9**	**$127.3**
Percentage Change from Peak 2007-08 General Fund Spending		-3.5%	-4.0%	-2.6%	-5.1%	-1.9%	4.8%	24.7%	27.7%

Department of Finance – Schedule 9

In addition to $115.3 billion General Fund, the 2015-16 Governor's Budget relies on (1) $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) $1.1 billion of weight fees to pay general obligation transportation bond debt, (4) nearly $2.1 billion of Medi-Cal related special taxes and cost shifts, and (5) directing $534 million of federal Temporary Assistance to Needy Family money to fund CalGrants. 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.

General Fund revenues have rebounded. **Actual General Fund expenditures are proposed to exceed 2007-08 spending levels by $12.3 billion** (10 percent higher). However, "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.**

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 what appears to be 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 $1.8 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 almost $3.3 billion (roughly 40 percent) of projected 2015-16 Proposition 30 revenue to programs other than K-14 education:

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

	2015-16
Minimum Prop 98 guarantee with no Prop 30 revenue [1/]	**$63.381**
Proposition 30 revenue	**$8.301**
Minimum Prop 98 guarantee plus all Prop 30 revenue	**$71.682**
Prop 98 funding included in 2015-16 budget	**$68.409**
Prop 30 revenue used for non-education programs	**$3.273**

[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 $63.4 billion.
- Estimated revenue from Proposition 30 in 2015-16 is just over $8.3 billion.
- Thus, despite multi-billion dollar growth in Proposition 98 funding, it is still almost $3.3 billion below what it would be if all Proposition 30 revenue was spent on K-14 education, as promoted by its supporters.
- 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 Continues to Rise Dramatically. 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

Numbers in thousands	2013-14 at 14-15 FBA[2]	2013-14 at 15-16 MR[3] (revised)	change from FBA to MR	2014-15 at 14-15 FBA	2014-15 at 15-16 MR (revised)	change from FBA to MR	2015-16 MR	change from revised 14-15
K-12 education [1/]								
General Fund	$38,465	$38,669	$204	$40,092	$44,552	$4,460	$44,035	-$517
Local property tax revenue	$13,405	$13,736	$331	$14,089	$14,432	$343	$16,380	$1,948
K-12 subtotal	$51,870	$52,405	$535	$54,181	$58,984	$4,803	$60,415	$1,431
California Community Colleges [4/]								
General Fund	$4,187	$4,248	$61	$4,293	$4,975	$682	5,300	325
Local property tax revenue	$2,167	$2,182	$15	$2,308	$2,263	-$45	2,613	350
CCC subtotal	$6,354	$6,430	$76	$6,601	$7,238	$637	$7,913	$675
Other Agencies	$78	$78	$0	$77	$80	$3	$80	$0
Total Proposition 98 [5/]	$58,302	$58,913	$611	$60,859	$66,302	$5,443	$68,409	$2,107
General Fund	$42,730	$42,996	$266	$44,462	$49,608	$5,146	$49,416	-$192
Local property tax revenue	$15,572	$15,918	$346	$16,397	$16,695	$298	$18,993	$2,298

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

[2/] FBA = final budget act

[3/] MR = 2015 May Revision

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

[5/] Any discrepancies are due to rounding

As the chart shows, Proposition 98 spending rises dramatically from the amounts assumed in the 2014-15 Budget Act, from $58.3 billion to $58.9 billion in 2013-14 (up $612 million); from $60.9 billion to $66.3 billion in 2014-15 (up $5.4 billion), and to $68.4 billion in 2015-16, up $2.1 billion from the revised current-year level, a new all-time high.[1] This funding surge is partially attributable to the "maintenance factor" obligation payments imposed in 2014-15 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 $772 million, down from a high of over $11.2 billion in 2008-09.

Wall of Debt Continues to Fall: Mandates Backlog Further Reduced. Consistent with his January proposal, the Governor continues to use some of 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 $3.57 billion in 2014-15 ($3.24 billion for K-12 schools and $407 million for community colleges) and over $235 million in 2015-16 ($82 million for K-12 schools and $153 million for community colleges) to reduce the backlog of unpaid K-14 education mandate claims to about $2.2 billion. *Senate Republicans are supportive of these efforts.*

Local Control Funding Formula Grows Toward Its 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

[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 $11.8 billion.

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 May Revision provides about $2.1 billion more LCFF funding than the January proposal, for a total 2015-16 increase of about $6.1 billion, leaving a gap of just under $6 billion between proposed and target funding levels. *Senate Republicans supported the Governor's proposal to use the bulk of new Proposition 98 funding to move schools toward their LCFF funding targets, as the LCFF boosts local control and education is one of the state's highest budgetary priorities.*

Funding Boost for Career Technical Education (CTE) Transition Grants. In an effort to ensure that CTE programs continue after the existing two-year maintenance of effort (MOE) requirement ends on June 30, 2015, the Governor's January budget proposed a new transitional CTE incentive grant program funded at $250 million each year for three years, with a required 1:1 local/state funding match. The May Revision boosts funding for this proposal and restructures it to soften the funding "cliff" at the end of the grant period and to give priority to schools in rural areas and regions with high dropout rates. Rather than $250 million per year with a 1:1 local/state match requirement for the entire period, the revised proposal would provide $400 million in year one, with a 1:1 state/local match requirement; $300 million in year two, with a 1.5:1 local/state match requirement; and $200 million in year three, with a 2:1 local/state match requirement. In years four and beyond, schools would be expected to run the program on their own, using their flexible LCFF funding. *The additional $150 million over three years is a welcome enhancement to the January proposal, but an even better approach would be to provide permanent funding for these programs, which are a longstanding budgetary priority of Senate Republicans.*

Child Care and Preschool Continue to Expand Without Program Reforms. The Governor's January budget proposed a $101 million augmentation for continued implementation of the multi-year child care and state preschool expansion plan launched in 2014-15. The May Revision adds another $88 million (most notably for a 2,500 slot expansion and a one percent rate increase for part-day state preschool, and for CalWORKS caseload and cost adjustments), bringing the total year-over-year increase to $189 million. 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 providers to assure that children are present at the times claimed, and funding for fraud investigators, have gone unheeded. The May Revision does *not* fund child care with Proposition 98 General Fund, as program advocates have recently demanded. *Senate Republicans believe that Proposition 98 spending should continue to be prioritized for K-14 education as the voters intended -- it should not be manipulated to free up General Fund for other uses.*

Fiscally Irresponsible School Budget Reserve Restrictions Remain. The 2014-15 education budget trailer bill imposed irresponsible 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 strongly opposed the restrictions because they are fiscally irresponsible and may disproportionately impact schools with high populations of low-income students, English learners, and foster youth. Unfortunately, neither the Governor's January budget nor the May Revision proposes to unwind them, despite his statement in January that "the Administration appreciates the

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

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 SB 774, introduced in February 2015 by Senators Fuller (R – Bakersfield), Bates (R – Laguna Niguel), Berryhill (R – Twain Harte), Huff (R – Diamond Bar), Morrell (R – Rancho Cucamonga), Nielsen (R – Gerber), and Vidak (R – Hanford), which would reverse these highly-objectionable restrictions.*

Governor Continues to Oppose Students in Vergara v. California. Although not part of the May Revision, the Governor has now joined with the teachers' unions to appeal the initial court decision in Vergara v. California. That 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 Plan for School Construction. The Governor's January Budget proposed 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, and 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. Unfortunately, neither the January budget nor the May Revision includes any specific proposals to ensure that schools' facilities needs are met. *Senate Republicans support adequate funding for school facilities, and encourage the Governor to engage toward that goal. Absent a specific alternative proposal, a 2016 state school bond may be the only viable option.*

Charter School Facilities Funding Grows. The Governor's January proposal provided $50 million to expand the existing Charter School Facility Grant Program for students in high-poverty areas, which provides $750 per unit of average daily attendance (ADA), up to 75 percent of a school's annual facilities rent or lease costs. The May Revision proposes to allow any funding remaining after these initial allocations are made to flow to these schools on a per-ADA basis (up to $1,000 per ADA or 100 percent of annual rent or lease costs). This is "pay as you go" funding which, unlike state school facility bonds, does not increase state indebtedness. *Senate Republicans support this proposal, as charter schools can provide innovative and effective educational experiences to many students, particularly low-income students, who may not be well-served by traditional government schools.*

Military School Facilities Loans Encouraged. The May Revision proposes to meet the needs of 11 public schools located on military installations that have serious condition or capacity deficiencies by arranging low interest loans from the state's Infrastructure and Economic Development Bank. The federal government has offered $240 million to address these schools' needs if they can come up with matching funds of about $61 million. Low-interest loans are better than nothing, but a $61 million General Fund appropriation, as proposed in SB 111 by Senators Fuller (R – Bakersfield) and Vidak (R – Hanford), would be even better. *Senate Republicans strongly support a General Fund appropriation for matching funds sufficient to draw down $240 million in federal funding for these sorely-needed repairs.*

Proposition 39 Energy Efficiency Funding Continues. The 2015-16 budget proposal provides $352.1 million in Proposition 98 funding for Proposition 39 energy efficiency projects, down slightly from

$359.7 million proposed in January but still well above the $316.5 million provided in 2014-15. K-12 schools' share will be $313.4 million and the community colleges' share will be $38.7 million.

Adult Education Expansion Rules Strengthened. In recognition of the pending expiration of a two-year MOE requirement for adult education on June 30, 2015, the Governor's January budget proposed $500 million for a block grant to expand adult education through regional consortia of K-12 schools and community colleges (the funding is displayed in the community colleges' budget, but could flow to any K-14 LEA). First call on the funds would be to backfill local expenditures currently required by the MOE, estimated at between $300 and $350 million. Remaining funds would be allocated by regional committees in accordance with locally developed guidelines. The May Revision continues the funding of $500 million, but in response to feedback from stakeholders, strengthens governance and accountability provisions, incorporates other adult education funding, provides earlier funding information to providers, and encourages more coordination among consortia members. Unfortunately, it still does not require that providers establish program goals (such as expected service levels) or incorporate effectiveness measures such as the use of common student identifiers to track student progress over time or across various providers. *Senate Republicans support strong program accountability measures and encourage K-12 schools and community colleges to work cooperatively to ensure the success of this major new investment.*

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 $6.43 billion in 2013-14, to $7.24 billion in 2014-15 (a year-over-year increase of $807 million), and again to $7.91 billion in 2015-16 (an increase of $676 million). In addition to the mandates, deferrals, and adult education proposals discussed above, the most notable adjustments in the CCC budget include:

- $266.7 million in unrestricted funding for increased operating costs (facilities, professional development, converting part-time to full-time faculty, retirement benefits, etc.), up from $125 million in January.
- $156.5 million for three percent enrollment growth, up from $107 million for two percent growth in January, 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.
- $148 million in one-time funding for deferred maintenance and instructional equipment
- $100 million for student success programs (orientation, assessment, placement, counseling, etc.) -- no change from January
- $115 million for "student equity plans" intended to close achievement gaps between underrepresented student groups and their peers, up from $100 million in January
- $75 million to hire more full time faculty
- $61 million for a 1.02 percent cost of living adjustment, down from $92 million for a 1.58 percent adjustment in January.
- $60 million in one-time funding to improve "basic skills" instruction for students who arrive unprepared for college-level work
- $48.6 million to increase funding for former "enhanced non-credit" courses[6], down from $49 million in January due to revised estimates for those courses

[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.

- $48 million to continue CTE education formerly funded through the expired Quality Education Investment Act -- no change from January
- $42 million to restore funding for campuses whose attendance fell, then grew
- $29 million for apprenticeship programs ($14 million for existing programs, and $15 million for new programs focusing on emerging industries and unmet labor demand) – no change from January
- $15 million to disseminate and implement effective professional, administrative, and educational practices, including development of curricula and practices for serving inmates and California Conservations Corps members as proposed by SB 1391 (Hancock, Chapter 695, Statutes of 2014).[7]
- $2 million for a pilot program to encourage the community colleges to partner with the California State University (CSU) to provide remedial education for students who have been admitted to CSU but are not yet able to do college-level work. The community colleges can provide this type of instruction at a lower cost than CSU can.

University of California (UC) and California State University (CSU). Consistent with his own multi-year funding plan for UC and CSU, the Governor's January budget proposal included 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 he intended to run through 2016-17. The chart below reflects funding levels proposed for UC and CSU in the May Revision:

UC & CSU Funding at 2015-16 Governor's May Revision
(Core funds, in millions)

		2013-14	2014-15	2015-16	change from 14-15
UC	General Fund	$2,844	$2,991	$3,227	$236
	Tuition and Fees [1/]	$3,664	$3,790	$3,893	$102
	Other UC Core Funds [2/]	$314	$323	$323	$0
	Lottery	$31	$39	$39	$0
	Total UC	$6,853	$7,142	$7,481	$339
CSU	General Fund	$2,769	$3,026	$3,220	$194
	Tuition and Fees [1/]	$2,764	$2,778	$2,814	$36
	Lottery	$36	$59	$59	$0
	Total CSU	$5,569	$5,863	$6,093	$230
	Total	$12,422	$13,005	$13,574	$569

[1/] Includes systemwide fees before discounts and waivers, and nonresident tuition.
[2/] Includes application fees, interest, and a portion of grant overhead and patent royalty income. Excludes carry-forward of prior-year balance in 2013-14 under the assumption that most of this balance will continue to be carried forward.

Source: Legislative Analyst's Office

The May Revision reflects enhanced funding for UC consistent with the terms of an agreement recently negotiated between the Governor and UC President Janet Napolitano. In addition to the January proposals for a $119 million base funding increase and $25 million in one-time funds for deferred maintenance, the revised budget proposal reflects the following changes:

[7] http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_1351-1400/sb_1391_bill_20140927_chaptered.pdf

- No undergraduate resident tuition increases through 2016-17 – tuition increases thereafter will be no higher than the rate of inflation.
- A two-year extension of the annual four-percent General Fund base augmentations, through 2018-19.
- \$436 million in one-time Proposition 2 "Rainy Day" funds across three years, starting with \$96 million in 2015-16, to help pay down UC's unfunded pension liability. These funds are to supplement, not supplant, existing UC funds.
- Adoption by the UC Regents of defined benefit pension caps for newly-hired UC employees, consistent with those imposed by the Public Employees' Pension Reform Act of 2013 (PEPRA). UC's current pension cap is \$265,000; the PEPRA cap is currently \$117,020.
- \$25 million in one-time state "cap and trade" funding for energy efficiency projects.
- UC will make operational changes to assist transfer students, streamline course requirements, make better use of summer sessions, and develop three-year degree pathways, among other changes.

Outside of the May Revision agreement, UC indicates an intention to increase "student services fees" by five percent annually starting in 2015-16, increase non-resident supplemental tuition by up to eight percent annually, and continue with its existing plan to increase graduate professional degree tuition over time (except for law schools, where tuition will remain flat through 2018-19).

For CSU, in addition to the Governor's January proposals for a \$119 million base funding increase and \$25 million in one-time funds for deferred maintenance, the May Revision proposal adds:

- \$38 million in base funding, with encouragement to use the funds to reduce time-to-degree and increase the number of transfer students admitted
- \$35 million in one-time state "cap and trade" funding for energy efficiency projects

Senate Republicans stand with students, teachers, and families in resisting increases in tuition and other costs (Senator Anthony Cannella (R – Ceres) introduced SB 58[8] in 2013 to statutorily freeze tuition through 2018-19). It is important 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.[9] *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.*

Veterans' In-state Tuition Assured. The May Revision includes language to ensure that all students using federal GI Bill benefits to attend college will be exempt from paying nonresident tuition and any other fees exclusively applicable to nonresident students, which was the intent of last year's AB 13 (Conway, Chapter 639, Statutes of 2014). *Senate Republicans strongly support this effort to make college available to our veterans, who have put their lives on the line to ensure the daily freedoms we enjoy.*

No Effort to Stop Looming Student Aid Reduction. During the recession, the Legislature took action to reduce state spending by reducing the maximum CalGrant award for students attending non-profit and private for-profit independent colleges and universities accredited by the Western Association of Schools and Colleges (e.g., University of the Pacific, Pepperdine, Stanford, USC, etc.) from \$9,708 to \$9,084 on July 1, 2012, and from \$9,084 to \$8,056 on July 1, 2015. The economy has improved

[8] http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0051-0100/sb_58_bill_20130107_introduced.pdf

[9] 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

considerably, but the 2015 reduction is still on the books and will take effect as scheduled unless the Legislature acts to reverse it. *Senate Republicans support the timely reversal of this student aid reduction. Independent accredited colleges and universities can be a great bargain for taxpayers, as the state provides no funding for them outside of the CalGrant student financial aid subsidy for their students.*

Health and Human Services

Health

The following table summarizes changes in proposed General Fund spending levels and significant changes since January 2015 for the largest departments that administer state health programs. Key issues are discussed below.

Summary of Department General Fund Spending
Dollars in Millions

Department	2014-15 Enacted Budget	2014-15 Revised Estimate	2015-16 Proposed Budget	Change from 2014-15 Enacted Budget to 2015-16		Key Changes From Current Year
				$	%	
Health Care Services: Medi-Cal	$17,280	$17,521	$18,172	$ 892	5.1%	Continued enrollment growth due to federal health reform, partially offset by $381 million in additional federal funds for the Children's Health Insurance Program (CHIP), which is part of Medi-Cal.
Developmental Services	2,961	3,098	3,300	339	10.9%	Additional community development funds for residents moving out of developmental centers; enrollment growth of 4 percent.
Public Health	118	120	124	6	5.0%	Capital improvements at Richmond Lab.

Medi-Cal

Enrollment for “Deferred Action” Immigrants. The May Revision includes $33 million General Fund for increased enrollment in Medi-Cal by undocumented immigrants resulting from President Obama’s “deferred action” executive order from November 2014. This funding proposal assumes that the legal injunction currently blocking implementation of the President’s order will be overturned by an appeals court ruling. Some estimates suggest that more than 1.2 million undocumented immigrants in California may be eligible for deferred action status, but the budget assumes a relatively small portion of these would enroll in state programs in 2015-16. The Administration estimates that once the changes are fully phased in, annual costs would be $200 million General Fund across all affected programs.

Under existing California and federal law, deferred action status may be granted under a limited number of circumstances and qualify someone as a Person Residing Under Color of Law (PRUCOL). Provided that income tests are also met, California already provides eligibility for full-scope Medi-Cal and certain other state-funded programs to PRUCOL residents. This means that with no further state policy changes, the new group of deferred status immigrants appear to be eligible as well. Thus, the Governor regards this funding proposal not as a change in state policy, but rather as recognition of the change in the federal policy landscape. What is clear is that this budget proposal will fund a federal policy that many Republicans view as an unconstitutional executive action. The nonpartisan Legislative Analyst’s Office has also pointed out that there is great uncertainty about when the legal process will be resolved and that the proposed funding level is too high even if there is a quick resolution. Given these concerns, a more prudent course of action would be to await resolution in the courts before authorizing funding. If the President’s order does in fact take effect, it would be appropriate at that time for the Legislature to have a broader discussion about the state’s PRUCOL policy in the context of Medi-Cal funding and program goals.

Managed Care Organization (MCO) Tax Still Proposed. The May Revision includes the same MCO tax revision that the Governor proposed in January. Republican concerns, which have not changed since January, include:

- The MCO 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, $228 million in higher tax revenue is intended to increase spending on the unrelated In-Home Supportive Services (IHSS) program because the Administration entered into a court settlement agreement with IHSS providers to seek a provider tax for that program. **Republicans did not support that agreement and there is no reason to support a new tax that would require 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.

Medi-Cal Enrollment Continues to Outpace Expectations. Total Medi-Cal enrollment is now projected to be 12.4 million, or **32 percent of the state's population.** This is an increase of 4.5 million, or 57 percent, compared to Medi-Cal's enrollment of 7.9 million prior to implementation of the federal Affordable Care Act, and includes the following:

- The "optional" Medi-Cal expansion, which covers low-income adults who do not have children, is now projected to reach 2.3 million enrollees in 2015-16, which is 15 percent higher than the Governor's projection in January. The federal government pays all costs for this group, totaling $13.8 billion in 2015-16, until 2017, but the state's share gradually increases to 10 percent of this group's costs by 2020-21, when **inflation and caseload growth could push the state's share to more than $2 billion General Fund per year.**

- The "mandatory" portion of the expansion is now expected to reach 1.4 million enrollees. The mandatory changes standardize the income ceiling and allow people to enroll in Medi-Cal regardless of the value of any assets they might have. The state pays half the costs for this group or $1.3 billion General Fund in 2015-16.

Medi-Cal Provider Rate Relief Missing. Medi-Cal enrollees already faced barriers to accessing health services even before the massive enrollment growth resulting from the ACA and the Governor's new proposal for Deferred Action immigrants. Nonetheless, the May Revision continues to implement a previously authorized 10 percent rate cut for most Medi-Cal providers, including a retroactive cut in many cases. This rate cut is now estimated to provide $200 million in General Fund savings in 2015-16. On April 21, 2015, Senate Republicans sent a letter to the chairperson of each house's budget committee urging restoration of the rate cuts. Without rate relief, **the current access issues will only get worse as enrollment grows.**

Significant Medi-Cal Deficiency. The May Revision projects that the Medi-Cal deficiency for 2014-15 is now $241 million General Fund. The primary cause of the deficiency is higher-than-expected enrollment associated with federal health reform. The Administration plans to seek a supplemental appropriations bill to fund this deficiency.

Department of Developmental Services

Developmental Centers Closure Plan. The May Revision includes a welcome and overdue proposal to close down three developmental centers (DCs) that house roughly 1,000 residents. This proposal would close Sonoma DC by the end of 2018 and would close Fairview DC and the non-secure portion of Porterville DC by 2021. The proposal shares the vision offered by SB 639 (Stone), which is currently held in Senate Human Services as a two-year bill. As part of the closure plan, the May Revision also proposes $49 million to develop community-based resources to accommodate residents who would shift from the DCs into the community. Closing the DCs is a prudent action to return to California's goal of serving the developmentally disabled in the community rather than in outdated institutions. Additionally, the already high-cost DCs face the loss of federal funds for failing to meet federal health and safety requirements. Senate Republicans applaud this proposal from the Administration and will review the details with the goal of ensuring a thoughtful approach.

No Rate Increases or Reforms for Community Services. Unfortunately, still absent from the May Revision is any proposal 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. 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. SB 638 (Stone, R-Riverside County) would launch needed reforms and provide a 10 percent rate increase for community services in 2015-16. Senate Republicans believe that budgetary action in this area is warranted to accomplish these goals.

Human Services

For the 2015-16 fiscal year, the Governor's May Revision provides $30 billion ($9.4 billion General Fund) for programs such as CalWORKs, In-Home Supportive Services (IHSS), Supplemental Security Income/State Supplemental Payment (SSI/SSP), CalFresh, and Child Welfare Services administered by the Department of Social Services. The May Revision increases spending by $597 million ($238.2 million General Fund) compared to the January budget, mostly as a result of caseload increases and slight increases in costs per case. Following are some of the most notable changes:

- **Earned Income Tax Credit Could Help Low Income Californians.** The May Revision includes a proposal to establish a state earned income tax credit, modeled after the federal program but applying only to individuals that receive a W-2 tax form (the federal program has seen significant fraud attributable to individuals in self-employed status). This program rewards hard-working Californians and could help recipients in the CalWORKs program as well as low-income adults across the state (*See EITC on page number 10*).

- **Presidential Immigration Action Impact State-Only Programs.** The May Revision includes $62 million, increasing to $200 million annually, for state-only program eligibility expansions consistent with President Obama's executive actions taken on November 20, 2014 that would allow certain families with undocumented parents and citizen children to be eligible for state funded full scope Medi-Cal, In-Home Supportive Services (IHSS) and Cash Assistance Payments for Immigrants (comparable to the SSI/SSP program). A federal district court judge has enjoined implementation of these actions and the Governor's budget assumes resolution of the litigation in the Administration's favor, including partial year funding in 2015-16. California must be careful to balance the desire to help those in need from other countries with the fiscal realities involved in balancing the state budget and serving existing citizens.

- **Continues to Assume Overtime for IHSS Providers.** The May Revision continues to provide funding to pay In Home Supportive Services providers overtime beginning July 1, 2015. Federal regulations require the state to pay overtime rates in the IHSS program, as well as provide reimbursement for travel time and time spent at medical appointments. The 2015-16 budget includes $720.9 million ($334.5 million General Fund) for these activities, with $352.2 million ($158.7 million General Fund) budgeted for IHSS overtime in 2015-16. Currently, however, a federal district court ruled that a portion of the new regulations exceeded the federal Department of Labor's authority and therefore implementation is delayed as the case works its way through the judicial system. The Governor originally proposed to establish a network of providers that recipients could utilize to avoid the overtime costs, but he ultimately abandoned that alternative under pressure from Democrats and their union allies that benefit from more overtime payments.

- **Moving From "Work First" Back to "Welfare First".** The May Revision proposes to create a new state-only program within CalWORKs for recipients that have been in sanction status (not participating in welfare to work activities) for more than one year. There are currently about 60,000 cases in sanction status and about 14,500 in long-term sanction status. The new state-only program would cost $170.8 million General Fund in 2015-16. By moving long-term sanction cases into a state-only program, the state removes the adult from the CalWORKs work participation rate (WPR) calculation, which would increase the state's WPR by 1.5 percent upon full implementation. For the past several years the state has failed to meet the federally required level of participation in the program and has been assessed $587.1 million in penalties for 2008, 2009, 2010, and 2011. Although creating a new state-only program that increases the state's work participation rate could be beneficial if it alleviates future federal penalties, the state has basically reverted back to a welfare model where recipients do not have to participate in the program, but merely have to cash the check.

Public Safety and Judiciary

Department of Corrections and Rehabilitation (CDCR)

Compared with the January Governor's Budget, the May Revision proposes to reduce General Fund support for CDCR by about $130 million. This reflects revised projections of the adult institutional population showing a decreased average daily population (ADP) of 127,990 in 2015-16 (down 3.8 percent from 133,109). Juvenile institutional ADP is also down from 709 to 677 in 2015-16 (a reduction of 32 wards, or 4.5 percent). Together, these revised population projections result in a reduction of $110.5 million General Fund and 134 positions. The rest of the $130 million reduction is comprised of an $11 million adjustment to debt-service payments resulting from lower-than-expected bond costs and various, mostly technical adjustments to previous proposals.

Reduction in Out-of-State Contract Beds. The state has already reduced its prison population to more than 2,200 inmates below the federal three-judge panel's final February 2016 benchmark. With Proposition 47 and other population-reducing measures projected to further shrink ADP by another 5,000 inmates or so, the May Revision proposes to reduce the use of out-of-state contract beds by about 4,000 (from about 9,000 beds to about 5,000). This change would result in General Fund savings of approximately $73.3 million, which accounts for about two thirds of the $110.5 million population-related reduction described above.

While reducing the state's reliance on out-of-state contract beds is certainly a desirable outcome, the Administration cautions against emptying these facilities too quickly. The high level of uncertainty associated with population reduction measures that are currently underway and the need to maintain compliance with the three-judge panel's population cap suggest that reducing capacity too soon could be catastrophic. If the state were to fall out of compliance, the court-appointed compliance monitor could require CDCR to immediately release potentially thousands of felons into our communities regardless of whether they have been rehabilitated and without concern for the risk they pose of reoffending. **Republicans agree that state officials should resist impulses to permanently reduce prison capacity before the long-term effects of recent policy changes affecting prison populations are better understood.** Reducing contract beds is a better option than closing prison facilities at this time because adding contract beds back if the population threatens to exceed the court-ordered cap would almost certainly be quicker and less costly than reopening a closed prison.

Transitioning Prison Medical Care Back to State Control

Implementing the Court's Receivership Transition Plan. The May Revision includes a $1.9 million General Fund increase to address additional workload in the Receiver's office resulting from a March 10, 2015 federal court order outlining a plan to transition control of prison medical care back to the state. The additional funds would support 16 positions that would implement the transition plan by developing policies and procedures, evaluating the suitability of individual facilities for return to state control, and ensuring continued compliance once control has been delegated to the state. Having the prison medical system under federal receivership has cost the state billions of dollars. Some of this spending was likely necessary, but some, it could be argued, was not. Everyone can agree, however, that the best scenario is for the state to operate a constitutionally adequate prison medical system, which would eliminate the need for federal court intervention. The state has been moving in that direction for some time now, and the resources included in the May Revision will move the state one more step toward retaking control of its prisons.

Improving the Inspector General's Medical Inspections. In order for the federal court to relinquish control of California's prison medical system back to CDCR, the state must ultimately demonstrate that it is delivering constitutionally adequate medical care to inmates. In 2013, the federal court's medical experts determined that the medical inspections being conducted by the Office of the Inspector General

(OIG) were ineffective in determining the quality of care being delivered to inmates. At the court's direction, the OIG consulted with the court's experts to develop a new inspection model, which the court approved for full deployment in February 2015. The May Revision provides $3.9 million General Fund and 19 positions to establish three new inspection teams to conduct annual medical inspections at all CDCR institutions. These teams will be critical to the state's ability to prove to the court that CDCR is capable of delivering a constitutional level of medical care to inmates in its custody.

Local Law Enforcement

The May Revision includes a number of proposals related to local law enforcement. Overall, these relatively minor changes provide little help for local agencies tasked with managing offender populations that were shifted from the state to counties as part of the 2011 Public Safety Realignment (Realignment). Republicans believe the state has a responsibility to provide our local government partners with sufficient funding to manage and supervise these offenders in a manner that enhances public safety and reduces recidivism through job training, mental health and drug treatment, and education. Sadly, the May Revision includes almost no additional funding to ensure the success of our local partners.

No Significant Increase in Realignment Funding. Compared to the Governor's Budget, the May Revision reflects a very small projected increase (about one third of one percent) in Realignment funding for local law enforcement in 2015-16 of $4.4 million, bringing total funding for this purpose to $1.2 billion. This is due to slight improvements in forecasted revenues from the sales and use tax and the Motor Vehicle License Fee. No additional help beyond this very small increase is proposed for local agencies to manage realigned offenders. With state revenues coming in at record levels, Republicans believe that the Governor is missing an opportunity to right the wrong he and legislative Democrats foisted upon local law enforcement agencies when they enacted Realignment and shifted more than 150,000 felons from state to local responsibility without adequately funding our local partners. Senate Republicans have introduced legislation to provide additional funding for sheriffs, probation departments, and other local agencies tasked with implementing Realignment. Legislative Democrats killed SB 144 (Cannella, 2013) on a party-line vote in the Senate Budget and Fiscal Review Committee. SB 353 (Nguyen, 2015) is currently awaiting a hearing in the same committee and is likely to suffer a similar fate. Both bills would give the savings from Realignment that are being "pocketed" by the state to local governments to better implement the program.

Fine-Tuning the Community Corrections Performance Incentives Grant Program. The May Revision includes an additional $1.1 million to reflect proposed modifications to the Community Corrections Performance Incentives Grant Program funding formula that was established by SB 678 (Leno & Benoit, 2009). SB 678 created a grant program to incentivize local probation departments to send fewer felony probationers to state prison by doing a better job rehabilitating them. The funding formula has been modified several times in an effort to continue providing compelling incentives for counties in the post-Realignment environment. The May Revision proposal would expand the SB 678 incentive program to target all felony offenders supervised by local probation departments, including 1) those on probation, and 2) the newly realigned population of felons on postrelease community supervision and mandatory supervision. This evolving program continues to be an important source of funding for counties that are willing to dedicate resources to improving outcomes for their supervised felon populations and a cost-effective way for the state to reduce its prison population.

Department of State Hospitals (DSH)

Restoration of Competency (ROC) Program Expansion. 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. Relative to the Governor's Budget, the backlog of ISTs awaiting placement has shrunk from about 400 in January to about 300 in May. One approach to reducing this backlog is to attempt to restore some of these offenders to competency while they are still incarcerated in the county jail. The May Revision includes $10.1 million General Fund for DSH to expand the existing 40-bed ROC program by as many as 108 beds.

While the ROC program shows promise in helping to reduce the IST backlog, it should not be relied upon as the sole solution to the problem, despite the desires of some not to expand the number of beds within the state hospital system. A significant percentage of IST patients awaiting transfer to a state hospital are not good candidates for the ROC program. For example, many ISTs must be involuntarily medicated to address the factors contributing to their incompetency, but the providers who operate the ROC program in the local jails are not legally able to administer medications to patients who refuse. A more balanced approach that includes both an expanded ROC program and additional IST bed capacity will likely be necessary.

Earthquake Repairs and Seismic Retrofitting at Napa State Hospital. The August 2014 earthquake that struck the City of Napa damaged eight buildings at Napa State Hospital (NSH). Four were "red tagged", meaning they will have to be demolished and rebuilt. The other four were "yellow tagged", meaning they will have to be substantially reconstructed. In September 2014, a federal disaster declaration was issued for the areas impacted by the quake, making the state eligible for federal reimbursement of 75 percent of the costs of repair. Under the federal declaration, the state is also eligible to receive a 75 percent federal match (up to $3 million) for seismic retrofits to buildings that were not damaged in the quake. NSH has one building that has been preliminarily approved for federal retrofit money. The May Revision requests a total of $6.8 million General Fund for the state's share of the costs of all phases of these projects. The proposal also includes budget bill language authorizing a $17.2 million loan from the General Fund to cover project costs until federal reimbursements are made. The federal disaster declaration following the Napa earthquake presents an opportunity for the state to address many seismic issues at NSH at a fraction of the cost that would otherwise be incurred. Approval of these projects would be a prudent, fiscally responsible use of state funds.

Judicial Branch

Backfilling User Fee Revenue Shortfalls. The May Revision increases the Governor's Budget proposal to provide a General Fund backfill for a shortfall in court user fee revenues from $19.8 million to $35.3 million (an increase of $15.5 million). This increase reflects a widening of the gap between revenue projections for court user fees and actual collections. The May Revision continues to propose permanently extending various temporary court user fee increases that were enacted in the 2012 Budget Act. Republicans believe these user fees represent barriers to justice for many would-be litigants. It is possible that part of the reason revenues have been falling short of projections is because the amount of the fees have reached a tipping point where some litigants can no longer afford to file their cases. Rather than keeping these barriers to justice in place, it might be time to reduce or eliminate them. Reducing court user fees and restoring General Fund support for the courts would increase access to justice for everyone, but especially for the least fortunate among us.

Transportation

Still No Transportation Proposal from Governor. The Governor's May Revision has only minor changes in the funding and programs for the Department of Transportation, however, the main theme continues to be the need for an extra $6 billion in annual new revenues to adequately maintain and repair state highways. The Administration continues to focus on pay-as-you go transportation user fees and not new bond funding, but has not put forward any proposal. This is not something that should be left for a last minute deal that lacks public scrutiny.

Republicans proposed SCA 7 (Huff, 2015) as a critical piece of any plan to increase transportation funding. SCA 7 will ensure that all existing and new transportation taxes and/or fees are used only for transportation purposes. Returning the $1 billion of annual truck weight fees to transportation projects is the first step towards fixing our transportation infrastructure problems. State General Fund can be backfilled from the billions of surplus state revenues that are currently pouring in. While much of the new revenue will go to K-14 education and the new Proposition 2 Rainy Day Fund – *as it should* – there is still sufficient room in the budget to prioritize our crumbling transportation infrastructure.

Using transportation taxes and fees for transportation purposes is fundamentally important, and we should make that a budget priority ***before hitting up our struggling middle class and low income families*** for more car and gas taxes.

Additional Funding for Vehicle Miles Traveled Study. The May Revision proposes a $1.3 million increase 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 that could replace the gasoline tax system. The final report is due June 30, 2018. Although this proposal could increase revenues for transportation programs, obstacles to its implementation include constitutional privacy questions and pricing concerns related to having a mileage tracking device placed on personal vehicles, not to mention general resistance from California motorists.

More Cap and Trade Funding for Public Transportation, Clean Vehicle Rebates, and Urban Housing Development. The Administration proposes a total of $1.6 billion in Cap and Trade revenues for public transit, High Speed Rail, and sustainable community development in 2015-16 (*see Resources Page 31*). The expenditure plan provides:

- $100 million for the Low Carbon Transit Operations Program.
- $265 million for the Transit and Intercity Rail Capital Program.
- $400 million for the Affordable Housing and Sustainable Communities Program.
- $500 million for the High Speed Rail project.
- $350 million for the Low Carbon Transportation Program within the California Air Resources Board.

Resources and Environmental Protection

More Emergency Drought Response Funding. The 2015-16 May Revision proposes an additional $2.2 billion ($1.9 Proposition 1, $120 million Cap and Trade revenues, $135 million General Fund, and $13 million special funds) on a one-time basis to continue drought response activities. The funding would be allocated as follows:

Emergency Drought Response
(Dollars in Millions)

Category	Department	Program	May Revision	Fund Source
Protecting and Expanding Local Water Supplies	Water Board	Groundwater Contamination	$784.0	Proposition 1
	Water Board	Water Recycling	$475.0	Proposition 1
	Water Board	Safe Drinking Water in Disadvantaged Communities	$180.0	Proposition 1
	Water Board	Wastewater Treatment Projects	$160.0	Proposition 1
	Water Board	Stormwater Management	$100.0	Proposition 1
	Department of Water Resources	Groundwater Sustainability	$60.0	Proposition 1
	Department of Water Resources	Desalination Projects	$50.0	Proposition 1
Water Conservation	Department of Water Resources/Energy Commission	Urban Water Conservation	$104.0	Proposition 1/ Cap and Trade
	Department of Water Resources/Department of Food and Agriculture	Agricultural Water Conservation	$75.0	Proposition 1/ Cap and Trade
	Department of Water Resources/Energy Commission	Make Water Conservation a Way of Life	$43.0	Proposition 1/ Cap and Trade
	Department of General Services	Water Conservation at State Facilities	$23.4	General Fund/ Special Funds
Emergency Response	Department of Forestry and Fire Protection	Enhanced Fire Protection	$61.8	General Fund
	Office of Emergency Services	California Disaster Assistance Act	$22.2	General Fund
	Department of Water Resources	Removal of Emergency Salinity Barriers in the Delta	$22.0	General Fund
	Department of Community Services and Development	Farmworker Assistance	$7.5	General Fund
	Department of Housing and Community Development	Rental Relocation Assistance	$6.0	General Fund
	Water Board	Executive Order Implementation	$1.4	General Fund
Total			**$2,175**	

Resource: Department of Finance

To date, the Legislature has appropriated $1.9 billion in drought funding to assist drought-impacted communities though most of the funding has gone towards long-term infrastructure projects. Of the

$2.2 billion in additional funding, $1.7 billion will be used for additional long-term infrastructure projects with funding available over the next three years.

More Enforcement Powers Given to the State Water Resources Control Board (Water Board). Within the emergency drought funding package, the Water Board receives $1.4 million General Fund to increase enforcement of water use restrictions and conduct additional inspections of diversion facilities to verify compliance with water rights laws pursuant to the Governor's Executive Order B-29-15. This Executive Order requires statewide mandatory water reductions and directs the Water Board to reduce potable urban water use by 25 percent. The Water Board adopted regulations in May to enforce these conservation measures. In addition, the Executive Order also:

- Prioritizes state review and decision-making of new water infrastructure projects.
- Requires agricultural water users to report more water use information, increasing the state's ability to enforce against illegal diversions, and the waste and unreasonable use of water.
- Requires landscapes for new homes and developments to be highly water efficient, and bans watering of ornamental grass on public street medians.
- Encourages local water agencies to adjust their rate structure to implement conservation pricing.
- Simplifies the review and approval process for voluntary water transfers and emergency drinking water projects.

The Administration will be proposing a trailer bill to provide the statutory authority to implement these actions. As part of this proposal, there will be new requirements on pre-1914 and riparian water rights holders to annually report their diversions, install diversion measuring equipment, and additional inspection and curtailment authority. It is possible that the reporting requirements could be required permanently on a monthly basis*.* The bill would also enhance local enforcement authority, increase monetary enforcement penalties, and allow funds to be used for local conservation efforts. These penalties would be administered by wholesale and retail water agencies, as well as city and county governments. These local entities would also be able to enforce local water waste restrictions and Water Board conservation restrictions. ***Senate Republicans believe that the current drought demands immediate and serious action, but are very concerned that these broad new powers may go too far and could lead to abuse by unaccountable government bureaucrats.***

Groundwater Sustainability Funding. Of the $2.2 billion, the Administration is proposing $60 million Prop 1 to support local groundwater planning efforts, of which $50 million is available over the next three years for technical and direct assistance and grants to local agencies for groundwater sustainability governance and planning. The additional $10 million would provide immediate funding dedicated to counties with stressed groundwater basins to update or develop local ordinances and plans to facilite basin-wide sustainable groundwater pursuant to the Sustainable Groundwater Management Act.

Increases in Water Rights Fees. The Water Board is proposing to spend $8.2 million ($4.1 Water Rights Fund and $3.7 million General Fund) on an expedited and expanded Bay-Delta Water Quality Control Planning and Implementation effort to update flow objectives and other standards that would expedite the completion of new requirements for Delta outflow. The Water Board will also be determining new flow objectives that protect fish and wildlife. This protection of beneficial uses in the Delta watershed would be implemented through water rights actions. Water rights holders statewide would be required to pay increased fees in order to provide fish more water and improve water quality within the Delta. ***This water quality program does not provide a direct benefit to water rights holders and is not consistent with Proposition 26, thus the fees are inappropriate and should be challenged in court.***

Easy Access to Private Well Logs. The Governor has proposed trailer bill language in an April Finance Letter that would rescind the confidentiality of well logs and make them available to the general public. Well logs are already required to be submitted to the Department of Water Resources and are available to the appropriate public agencies for the purposes of managing groundwater. It is difficult to understand the benefit of making this confidential private property information available to the public. The Department of Water Resources would need approximately $625,000 in one-time funding to upload well logs into a database system. These well logs would be available to the public via computer and there will be no requirement to obtain the information in person or show any form of identification. The department plans on redacting the owners name and address but the location of the wells will still be available. This appears to be another government overreach that infringes on personal privacy.

Governor Spends New Cap and Trade Windfall. The May Revision proposes to spend another $1.2 billion in Cap and Trade tax revenues in 2015-16 on various programs to meet the new greenhouse gas (GHG) reduction target of 40 percent below 1990 levels by 2030 pursuant to Executive Order B-30-15. The funding would be allocated as follows:

Cap and Trade Expenditure Plan
(Dollars in Millions)

Category	Department	Program	Jan 10/ Accelerated Drought	May Revision	Total
Sustainable Communities and Clean Transportation	High-Speed Rail Authority	High-Speed Rail Project	$250	$250	$500
	State Transit Assistance	Low Carbon Transit Operations Program	$50	$50	$100
	Transportation Agency	Transit and Intercity Rail Capital Program	$100	$165	$265
	Strategic Growth Council	Affordable Housing and Sustainable Communities Program	$200	$200	$400
	Air Resources Board	Low Carbon Transportation	$200	$150	$350
Energy Efficiency and Clean Energy	Department of Community Services and Development	Energy Efficiency Upgrades/Weatherization	$75	$65	$140
	Department of General Services	Energy Efficiency for Public Buildings	$20	$20	$40
	University of California/ California State University	Renewable Energy and Energy Efficiency Projects	$0	$60	$60
	Department of Water Resources/Department of Food and Agriculture	Water and Energy Efficiency	($30)	$60	$60
	Energy Commission/ Department of Water Resources	Drought Executive Order - Rebates for Appliances	$0	$30	$30
	Energy Commission/ Department of Water Resources	Drought Executive Order - Water and Energy Technology Program	$0	$30	$30
	Department of Food and Agriculture	Agricultural Energy and Operational Efficiency	$5	$20	$25
Natural Resources and Waste Diversion	Department of Fish and Wildlife	Wetlands and Watershed Restoration	$25	$40	$65
	Department of Forestry and Fire Protection	Forest Health	$42	$50	$92
	Department of Food and Agriculture	Healthy Soils	$0	$20	$20
	Cal Recycle	Waste Diversion	$25	$35	$60
Total			**$992**	**$1,245**	**$2,237**

Resource – Department of Finance

The Governor has also required that state agencies incorporate climate resiliency into planning and funding decisions to protect the state's resources from California's changing climate. To meet these new targets the Governor wants to increase renewable energy by 50 percent, reduce petroleum use by 50 percent, and double energy efficiency at existing buildings by 2030. AB 32 allows for the reduction of GHG to 1990 levels by 2020, but there is no legal authority to implement these new GHG reductions.

The Governor and Legislative Democrats are encouraged by the latest auction results, which brought in $630 million dollars in additional Cap and Trade tax revenues. The May Revision assumes revenues of at least $2 billion in 2015-16. This is due to fuels being brought under the cap in January of 2015 and subject to GHG reductions. ***California now has the most expensive gasoline in the country. These increased gas prices will further increase the cost of living and hurt low and middle income families the most.*** To reduce these negative effects, Senate Republicans continue to support the repeal of the "hidden gas tax" and recommend the use of these revenues for projects that provide significant amounts of GHG reductions while relieving pressure on California businesses.

The Governor continues to use Cap and Trade tax revenues to fund the High Speed Rail (HSR) project which does not meet the requirements of reducing GHG emissions since the project would actually increase GHG significantly during construction. Most of these projects have little, if any, nexus to GHG reductions and the confirmation of GHG reductions will be difficult if not impossible to measure. 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.

To date, the ARB has held ten auctions that have generated $1.6 billion in state revenues. In addition, $1.9 billion has also been generated for investor and public owned utilities to use as directed by the California Public Utilities Commission or governing boards for ratepayer benefits. Expenditures for 2013-14, 2014-15, and 2015-16 total $3.2 billion, which means an additional $2 billion in revenues are needed from future Cap and Trade auctions in 2015-16 to fund current proposals. If these revenues do not materialize as estimated, projects and programs would need to be postponed or cancelled. It would be more fiscally prudent to build a reserve prior to appropriating billions of dollars that the state hasn't received yet. Furthermore, the state may have to repay billions of dollars of Cap and Trade funds to capped entities if the state loses the current court case.

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.

Another Questionable Use of the SRA Fee. The May Revision proposes to spend an additional $1.3 million annually for a public education campaign on fire preparedness and for archaeological assistance to implement the requirements of AB 52 of 2014 related to lead agency consultative requirements with Native American Tribes. This public awareness campaign and new CEQA workload may provide a public benefit but it does not provide a direct benefit to the landowners paying the SRA fee. Targeting these funds to programs that do not provide a direct benefit to each homeowner paying the fee is inconsistent with Proposition 26 (2010) requirements. As such, the legality of the SRA fee remains under litigation.

Fireworks Disposal. The May Revision includes $5 million one-time from the Toxic Substances Control Account for the Office of the State Fire Marshall to dispose of illegal stockpiles of fireworks and to form a plan for future fireworks disposal. Senate Republicans uniformly opposed the Administration's "Fourth of July Tax" on fireworks last year, and believe that the most appropriate funding source should be the General Fund since this is a public safety issue that provides a general public benefit.

Labor and Workforce Development

Labor and Workforce Development Agency (Agency)

Temporary Worker Pilot Program. In relation to the Governor's proposals to implement the President's executive actions regarding immigration, the May Revision includes $148,000 General Fund to establish a 2-year pilot program within the Agency to help prevent abuses in the recruitment of H-2A temporary workers. The intent of this program would be to improve transparency and accountability in the recruitment of these workers to reduce exploitation and prevent labor violations within this workforce. Senate Republicans are generally supportive of these efforts to protect immigrants that are taking the lawful path to work in this state.

Employment Development Department (EDD)

Unemployment Insurance (UI) Administration. In January, the Governor's Budget provided $39 million General Fund in 2015-16 (including $21.7 million carried over from prior years) to fund the shortfall between the federal government's estimate of what it should cost to administer the UI program and resources available in EDD's budget. The May Revision would provide for a net $8 million decrease in UI administration funding for 2015-16 (including a $19.2 million General Fund reduction) to reflect federal funding reductions and natural workload reductions due to an improving economy. In addition, the May Revision proposes to save an additional $21.7 million General Fund related to shifting costs from the General Fund to two special funds within the department.

UI Loan Interest Rate Reduction. The Governor's Budget included $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 May Revision decreases that amount by $9.9 million to reflect a reduction in estimated interest costs.

Workforce Innovation Opportunity Act (Opportunity Act) Discretionary Fund Adjustments. The May Revision proposes $17.8 million federal funds to reflect an increase in discretionary funds (an increase from 8.75 percent to 10 percent of the federal allotment). These funds would be used to continue such workforce initiatives as the Slingshot Program, the Regional Workforce Accelerator Grant Program, and the Governor's Award for Veteran's Grants Program, as well as administrative resources for the new Opportunity Act. Senate Republicans have been supportive of the Opportunity Act and its coordinated regional approach to improving the range of educational outcomes and providing tangible skills that meet the needs of employers.

Local Government

Redevelopment Agencies

When it eliminated RDAs in 2011, the state established "successor agencies" to ensure the timely retirement of outstanding RDA debts and other legal obligations. The change resulted in property tax dollars being redirected back to cities, counties, special districts, and K−14 schools. According to the Department of Finance, since 2011-12 approximately $4.2 billion in general purpose revenue has been returned to cities, counties and special districts, and $4.3 billion of additional property tax revenues has been distributed to K-14 schools. The following table reflects how much has been allocated to these entities, and also reflects amounts of revenues that are projected to be allocated through 2017-18.

Fiscal Year	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	$1,645.3	$963.8	$272.8	$309.4	$99.3
2015-16 Estimate	$2,056.1	$1,116.8	$335.6	$481.2	$122.5
2016-17 Estimate	$2,039.3	$1,112.4	$375.8	$420.8	$130.3
2017-18 Estimate	$2,379.3	$1,307.6	$434.7	$486.5	$150.5

Resource: Department of Finance

Pursuant to Proposition 98, increased property taxes for schools effectively reduce the amount of General Fund revenues necessary to meet the annual minimum funding guarantee. On an ongoing basis, Proposition 98 General Fund savings are estimated to exceed $1.1 billion annually, and it is estimated that additional ongoing property tax revenues of more than $900 million annually will be distributed to cities, counties, and special districts.

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.

Simplifying Dissolution Process. As part of the Governor's Budget, the Administration proposed trailer bill language to "simplify" the ongoing administrative process and gradually transition the state away from the current detailed role in the RDA dissolution process. Over the past several months, however, that proposal has met with significant opposition, primarily from cities throughout the state. According to the May Revision, the Department of Finance has met with many local government entities to discuss concerns and determine how the legislation could be amended to meet the needs of cities and counties while maintaining the continued orderly wind-down of former RDAs. The May Revision now proposes significant amendments that the Administration believes will resolve the opponent's concerns. Senate Republicans will work with our local government partners and other stakeholders to ensure that this proposal does not exacerbate the problems created by RDA dissolution.

Local "Sweeteners." In addition to changes to the RDA dissolution proposal above, the May Revision proposes a variety of other local government changes, which appear to be intended to soften the blow of the RDA dissolution trailer bill. These changes have been the subject of a variety of policy bills over the past few years, including:

- “Negative Bailout.” The May Revision would end negative property tax adjustments and would provide approximately $6.9 million in annual relief to six counties (Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity).
- Newly Incorporated Cities. The May Revision would allow four cities in Riverside County that incorporated after 2004 to participate in the Vehicle License Fee (VLF) Swap mechanism. These four cities (Wildomar, Eastvale, Menifee, and Jurupa Valley) currently owe about $24 million to Riverside County. This proposal would absolve these cities of this debt by reducing the reimbursements Riverside County must provide to the Department of Forestry and Fire Protection (CalFIRE) for fire services. Riverside County will then forgive the debt to the four cities and the General Fund will backfill CalFIRE for its reduced reimbursements.
- San Benito County. The May Revision would allow local agencies in San Benito County to participate in an Education Revenue Augmentation Fund (ERAF) repayment program (they are currently ineligible), which will result in the state forgiving about $3.4 million of the $4 million owed.
- Tax Equity Allocations. The May Revision ends the requirement that four cities in Santa Clara County reimburse the county for tax equity allocations, which would allow these cities to retain about $2 million of ERAF funding.
- Prior Years Insufficient ERAF. The May Revision appropriates $5.8 million General Fund to reimburse the Counties of Amador, San Mateo, and Alpine (and cities located therein) to backfill when there is insufficient revenue in the County ERAF to reimburse the cities and counties for their VLF Swap and (Triple-Flip) costs.
- Low-Moderate Income Housing in San Francisco. Allows San Francisco’s redevelopment successor agency to receive former tax increment revenues and issue debt to pay for specified affordable housing activities. This language is not identified in the May Revision highlight document, but looks very similar to language in SB 441 (Leno, 2015). San Francisco faces extraordinary housing affordability challenges for a variety of reasons, however, Senate Republicans question the preferential treatment being provided to San Francisco’s successor agency in what will ultimately be a $361 million General Fund bailout. Other cities and counties throughout the state should be afforded the same opportunity as the wealthy and powerful San Francisco elite.

State Mandated Local Programs

Pre-2004 Mandate Reimbursements. The May Revision projects that the “trigger mechanism” included in the 2014 Budget Act will be executed in the current year, and the state will repay cities, counties, and special districts everything that is owed to them for mandate costs incurred prior to the passage of Proposition 1A in 2004. Prior to the end of 2014-15, the state will pay $765 million to cities (22 percent), counties (77 percent) and special districts (1 percent).

Employee Compensation

Addressing Civil Service System Problems. The Department of Finance is proposing significant changes to traditional state department practices as they relate to budgeting for personnel, including the elimination of vacant positions and the use of limited-term staff. The changes are intended to encourage state agencies to focus on managing their program funds to deliver outcomes rather than play bureaucratic games to skirt rules as is currently the case. However, the specifics of how the new system will work to improve oversight while increasing department flexibility are unclear. Senate Republicans want to see the details before evaluating the merits of these proposals.

For years, Republicans have raised concerns about the bureaucratic “shell games” that allow government officials to misuse funds connected to vacant state job positions for other purposes. According to a recent investigative report by the Sacramento Bee, state records show that there were 5,200 employees from 2010-11 through 2012-13 who had three or more transfers while keeping the same job title. The illegal job shifting cost taxpayers at least $80 million. Senate Republicans were instrumental in uncovering the problem and establishing reforms that led to Government Code Section 12439 in 2002, which requires state government officials to eliminate job positions if they are unfilled for six months. It may be the case that the rules need to be enforced with consequences rather than changed to give departments more flexibility as the Administration proposes.

State Employees Pay and Benefits Continue to Increase. 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 $594.9 million ($224.1 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**. In addition, state employee pension costs are $4.9 billion ($2.9 billion General Fund) in 2015-16, which is an increase of $338 million total funds ($203.5 million General Fund) or seven percent above 2014-15.

Four Bargaining Units with Expiring Contracts in 2015. Of the 21 bargaining units (BU), 17 have contracts in place through July 1, 2016 (with the exception of BU 5 - California Highway Patrol expiring July 3, 2018 and BU 8 - Firefighters expiring 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 retiree health care pre-funding plan. 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.

Retiree Health Care Benefits

Governor Pins Hopes on Public Employee Unions to Address $72 Billion Unfunded Liability. The Governor's January budget included a proposal to significantly change how the state funds healthcare for both current and retired employees and the May Revision continues the hope that those changes will be embraced by both the unions and the legislative Democrats. Although the budget includes principles to address the state's $72 billion retiree health care unfunded liability, the Governor's plan does not propose any additional contributions in 2015-16. Instead, the Governor is counting on unions to step up and concede more money out of the pockets of state employees. The problem with this, however, is that bargaining always includes concessions on both sides, and in the past, any additional employee contributions were almost always offset by salary increases, meaning that ***one way or the other the taxpayers will pick up the tab.***

Time is Running Out for Sustained Fiscal Plan. Unchecked, the unfunded retiree healthcare 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. The Governor's approach, which includes increasing the amount of time a newly hired employee must work for full vesting of health care benefits and reducing the state's contribution for retirees consistent with contribution levels during their working years, appears to be similar to prior Senate Republican proposals, although the devil is always in the details. Californians 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.

Statewide Debts and Liabilities

Updated Debt Payments in May Revision. The Governor's Budget proposes to repay about $7.9 billion of debts and liabilities by the end of the 2015-16 fiscal year, as follows:

- An estimated $765 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.
- 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 $1.5 billion 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 (consistent with Proposition 2).
- General Funds of approximately $4.1 billion in 2014-15 and $236 million in 2015-16 will be used to repay costs incurred by schools to comply with various education mandates, which were previously identified on the Governor's wall of debt.
- $96 million General Fund in 2015-16 (Proposition 2) to cover unfunded University of California pension debt, consistent with implementing a cap on salary eligible for pensions (see Higher Education page 19).

Debts and Liablitlites Eligible for Accelerated Payments Under Proposition 2 (Dollars in the Millions)						
	At Start of 2015-16	**Proposed Use of Proposition 2 Funds**				**Remaining Liabilities**
		2015-16	**2016-17**	**2017-18**	**2018-19**	
Budgetary Borrowing						
Loan from Special Funds*	$3,112	$1,502	$974	$560	$277	$0
Underfunding of Proposition 98 - Settle-Up	1,512	256	390	368	498	$0
Undpaid Mandate Claims for Local Governments prior to 2004-05	0	0	0	0	0	$0
State retirement Liablitlies					0	
State Retiree Health	71,773	0	0	0	0	N/A
State Employee Pensions	43,303	0	0	0	0	N/A
Teachers Pensions (state portion = 14.916 billion)	72,718	0	0	0	0	N/A
Judges's Pensions	3,358	0	0	0	0	N/A
Deferred payments to CalPERS	530	0	0	0	0	N/A
University of California Reitrement Liabitlies						
University of California Employee Pensions	7,633	96	171	169	0	$7,197
University of California Reitree Health	14,519	0	0	0	0	N/A
Unallocated					263	-$263
Totals	$218,458	$1,854	$1,535	$1,097	$1,038	$7,197

Of the $7.9 billion allocated for debt repayment, about $1.9 billion is related to Proposition 2 (see chart above). With over $200 billion in debts and liabilities still outstanding, it is clear California has a long way to go.

Senate Republican Fiscal Staff Assignments

Seren Taylor, Fiscal Director
Andrea Mullen, Budget Committee Assistant

Contact Number: (916) 651-1501

Assignment Area	Consultant
Education	Cheryl Black
Public Safety, Judiciary, Corrections	Matt Osterli
Energy & Environment	Rocel Bettencourt
Health	Kirk Feely
Human Services, Public Employees Retirement	Chantele Denny
Revenue, State & Local Government, Taxes	Joseph Shinstock
Transportation, Veterans, Housing & Consumer Affairs	Heather White

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