Highlights and Analysis of the Governor's Budget

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SENATE REPUBLICAN FISCAL OFFICE

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Executive Summary

For some people in our state today, life is truly California golden. High-tech industries and places like Silicon Valley are booming. However, this success has not been realized in all communities. Senate Republicans have identified key fiscal priorities that are essential to creating opportunity beyond just high-performing coastal areas. These issues, as summarized in the table below, span a range of challenges faced by everyday Californians. Senate Republicans will promote these priorities throughout the process of evaluating and voting on the state budget.

Making California Golden Again

Working to make California a great place for people to create their own, unique success story.

Building New Career Paths for Today's Economy
Our state's economic recovery unfortunately has left many Californians behind, searching for work or a new career. We want to empower California's workers with the right skills and opportunities to find and keep quality jobs.

Back to Basics: Great Roads and Reliable Water
In past decades Californians could take high-quality roads and plentiful water for granted, but government neglect has left these fundamentals in deep distress. Republicans are committed to building and restoring roads and water systems so that Californians can once again rely on these community essentials.

Keeping Our Communities Safe
Concerns about the safety of our neighborhoods and businesses are on all our minds. Republicans support smarter policies to make sure that our local law enforcement officers, courts, and jails have the tools and resources needed to fulfill their mission of protecting our communities.

Lifting Families Up: A Helping Hand for Working Californians
It's no secret that living in California costs more than in other states, in part due to government rules. Republicans want to offer a helping hand to make it easier for working families to pay the bills and put food on the table.

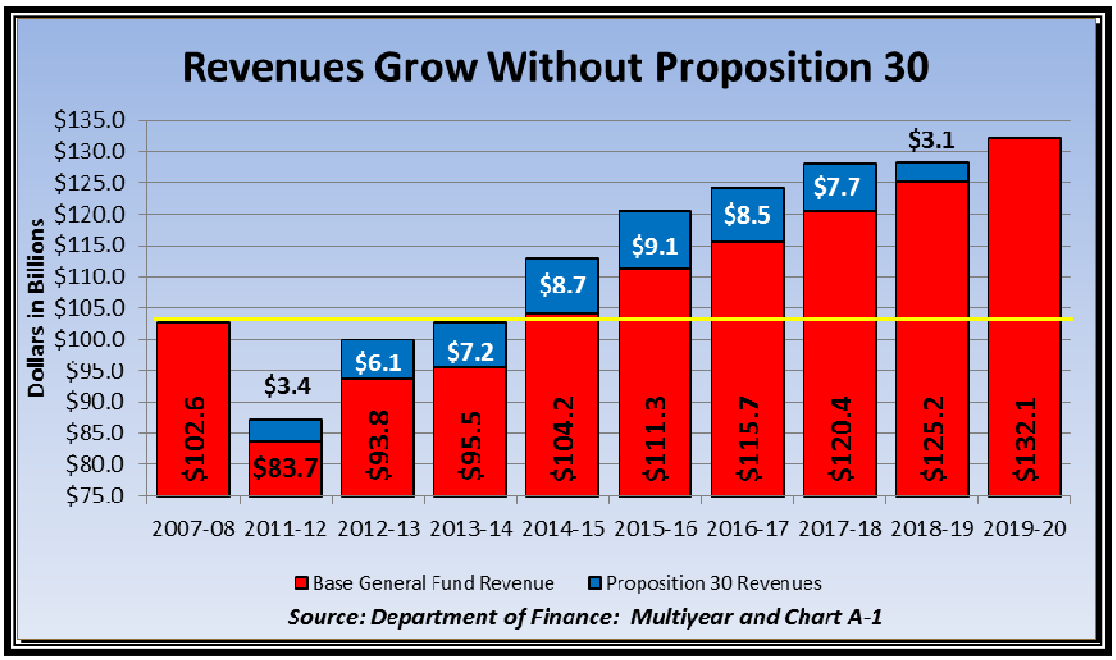
Keeping Our Promise to Those with the Greatest Needs
California made a promise long ago to care for people with the greatest needs, including people with developmental disabilities, but recent state decisions are jeopardizing that commitment. California already has the resources to make good on its promise, and Republicans believe we should do exactly that with no further delay.

Respecting the Voters Through Responsible Government
Californians showed that they expect state government to act in a responsible manner when they voted to improve the state's "rainy day" savings account and to keep tax increases temporary. Republicans will hold government accountable to the people by paying down state debts, fighting for transparency instead of dark-of-night deals, and making sure that those temporary taxes truly end as promised.

Budget Overview. The Governor's budget plan includes some major features that Senate Republicans can applaud, such as building up the state's Rainy Day Fund, bringing Proposition 98 education spending to an all-time high, and making some modest investments in career preparation and public safety. The Governor has also wisely cautioned against spending the short-term revenue surge on long-term commitments, and most of his new spending proposals are appropriately one-time in nature. However, the budget plan also falls short in some key priority areas, such as providing adequately for those with developmental disabilities and making needed investments in transportation infrastructure without raising taxes.

<u>Key elements of the budget plan include the following:</u>

Record Revenues. State tax revenues continue their strong recent growth and would reach $120.4 billion General Fund in 2015-16, growing to an all-time General Fund high of $124.4 billion in 2016-17. These amounts include $5.9 billion in unanticipated new General Fund revenue compared to expectations when the Budget Act passed last June. The budget also forecasts that revenues will grow every year through 2019-20, as shown in the chart below, demonstrating that the state does not need to extend or increase taxes to meet its priorities. Appropriately, the Governor's budget does not propose an extension of Proposition 30 temporary taxes. Allowing these taxes to expire as promised is consistent with Republicans' priority of *Respecting the Voters Through Responsible Government*.



Record Spending. General Fund spending increases to $116.1 billion in 2015-16 and grows further to a record $122.6 billion in 2016-17. About $4 billion of the proposed spending increase is for one-time expenses, including $500 million for deferred maintenance and $1.5 billion for pay-as-you-go infrastructure projects on state buildings in Sacramento.

Strong Rainy Day Reserve. The state's Rainy Day Fund (Proposition 2 of 2014) would grow to reach $8 billion by the end of 2016-17, and would include an extra deposit of $2 billion that would boost the reserve to 6.5 percent of General Fund revenue. Without this extra deposit, the Rainy Day Fund balance would be only 4.8 percent of revenue. In addition, the budget would also increase the non-Proposition 2 reserve to $2.2 billion, creating an overall reserve of over $10 billion. *Building the state's savings account to a healthy level beyond just the minimum requirement is consistent with Senate Republicans' priority of Respecting the Voters Through Responsible Government.*

Debts and Liabilities. The budget pays down $5.4 billion on outstanding infrastructure bonds, $1.6 billion toward Proposition 2-eligible liabilities, and $1.4 billion for education mandates. The Governor's approach would pay off only a small portion of state liabilities, which total more than $320 billion. While California's credit rating has improved in the past year (according to Standard & Poor's), 47 other states have higher credit ratings. *Consistent with the Senate Republican priority to Respect the Voters Through Responsible Government, the state could pay down additional debts and avoid future costs to help improve the state's credit rating.*

Higher Education. New proposals for Community Colleges include $200 million for "Strong Workforce" instruction and $30 million for basic skills remediation. For the University of California and California State University, the budget continues the previous plan for specific budget increases by providing 4 percent General Fund augmentations of $125 million each and one-time deferred maintenance funding of $35 million each. Tuition for both systems would remain flat. *These are consistent with Senate Republicans' priority of Building New Career Paths for Today's Economy.*

K-12 Education. Proposition 98 funding for K-12 education would grow by $4.7 billion over three years, and K-12 per-pupil spending would reach $10,600, an increase of 51 percent over the recent low in 2011-12. The Governor also proposes to repackage existing preschool and other funds totaling $1.7 billion into an early education grant program that could improve local control over early education.

Services for the Disabled. The budget takes a small step toward improving care for people with developmental disabilities (such as cerebral palsy), but could go much further. The $50 million General Fund proposed for community rate increases falls short of the need created by years of rate freezes and reductions. *The budget could do more to Keep Our Promise to Those with the Greatest Needs*.

Medi-Cal. The Medi-Cal program would grow to reach $19.1 billion General Fund in 2016-17 with 13.5 million Californians enrolled. Costs of coverage expansions under federal health reform continue to rise rapidly and now include an initial state cost of $740 million General Fund for the previously enacted "optional expansion" of coverage to adults. Unfortunately, the budget does not propose to restore rate cuts to doctors and other fee-for-service care providers.

Managed Care Organization (MCO) Proposal. The budget assumes that a revised version of the MCO funding package will be enacted, but most of the MCO revenues and expenditures are not included in the General Fund budget. This demonstrates that the MCO proposal is not necessary to balance the budget. Only $236 million in MCO proceeds are used for General Fund savings, in order to continue funding a prior year restoration to the In-Home Supportive Services program.

Human Services. The budget includes nearly a 3 percent cost-of-living increase to SSI/SSP grants, which amounts to $17 more per month for individuals and $31 per month for couples, at an annual cost of $80 million General Fund. This increase would be consistent with Senate Republicans' priority of *Keeping Our Promises to Those with the Greatest Needs.*

Public Safety. The budget proposes some modest investments in public safety such as $250 million General Fund for local jail construction, which would help mitigate overcrowding resulting from the 2011 Public Safety Realignment. The judiciary would also receive $30 million in grants to promote innovation and $60 million for deferred maintenance. While these promote the priority of *Keeping Our Communities Safe*, more could be done in this area.

State Infrastructure. While California's infrastructure needs are vast, the budget proposes to spend $1.5 billion one-time on pay-as-you-go renovations at certain state office buildings in Sacramento. Senate Republicans believe there are greater infrastructure needs than projects that would benefit primarily one city, such as by making a down payment toward our priority of getting *Back to Basics: Great Roads and Reliable Water*. Deferred maintenance of $500 million in total is also proposed across various areas, including community colleges.

Transportation Taxes. Unfortunately, the budget re-introduces the Governor's 2015 plan for tax increases on motorists to fund transportation infrastructure. The plan would include $3 billion generated by increased gas and diesel taxes and a road user fee, while continuing to redirect existing transportation revenues to fund the General Fund's debt service obligation. A superior approach is the 2015 Senate Republican proposal, which would provide $2.9 billion annually, plus $2.4 billion one-time, for California's roads and highways without increasing taxes.

Cap and Trade. The budget continues the Governor's Cap and Trade program by proposing to spend $3.1 billion on current programs such as high-speed rail, housing, and transit as well as new programs meant to reduce petroleum use by 50 percent. Much of this plan is based on the Governor's 2015 executive order that established new greenhouse gas emission goals for the state of 40 percent below 1990 levels by 2030.

Expenditures

The 2016-17 Governor's Budget includes revised General Fund expenditures of $116.1 billion in 2015-16 and projected General Fund expenditures of $122.6 billion in 2016-17. As shown in the table below, since the 2015 Budget Act was signed, spending in the current year has increased by $695 million, and the Governor has proposed to spend an additional $7.2 billion in 2015-16 (above the 2015 Budget Act spending level). As a result, while the following table reflects a year-over-year spending increase of $7.2 billion, the true spending increase is $7.9 billion over the 2015 Budget Act.

General Fund Expenditures by Agency

(Dollars in Millions)

Agency	Budget Act 2015-16	Revised 2015-16	2016-17 Governor's Budget	Year over Year Change from Budget Act
Legislative, Judicial, Executive	$3,158	$3,227	$3,330	$172
Business, Consumer Services, Housing	$627	$636	$434	-$193
Transportation	$261	$267	$222	-$39
Natural Resources	$2,479	$2,730	$2,909	$430
Environmental Protection	$69	$325	-$31	-$100
Health and Human Services	$31,867	$31,666	$33,742	$1,875
Corrections and Rehabilitation	$10,078	$10,276	$10,620	$542
K-12 Education	$49,373	$49,859	$51,230	$1,857
Higher Education	$14,200	$14,312	$14,567	$367
Labor and Workforce Development	$214	$212	$166	-$48
Government Operations	$738	$761	$2,245	$1,507
General Government/Other	$2,305	$1,793	$3,175	$870
Total, General Fund Expenditures	**$115,369**	**$116,064**	**$122,609**	**$7,240**
Accumulated spending increase since the Budget Act		$695	$7,240	**$7,935**
- As a Percentage		0.6%	6.3%	**6.9%**

Source: Department of Finance, Schedule 9

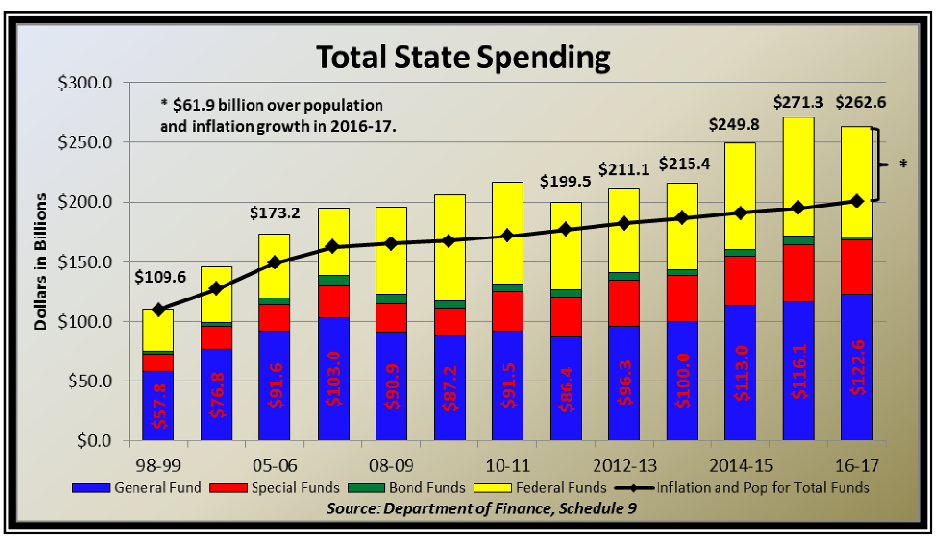
Key Takeaways on General Fund Expenditures:

- Total state spending, including General Fund, special funds, and bond funds, grows to $171.5 billion in 2015-16 and $170.7 billion in 2016-17. Adding federal fund spending (primarily in health and human services, education, and workforce programs) increases total budgetary spending to $271.3 billion in 2015-16 and $262.6 billion in 2016-17.
- One-time spending is key (given the volatility of new revenues). While we commend the Governor on his proposal to set aside $4 billion for one-time priorities, $1.5 billion of that amount could be better used to serve Californians statewide by fixing highways and roads and paying off additional state debts.
- California's government is growing. **The government is doing very well** during this recovery period, but that is no comfort to the hard-working families that have yet to recover or the state's substantial agricultural and energy industries that continue to suffer from stagnant wages and higher-than-average unemployment.
- Given the chances that the state will face a recession in the near future, the Governor has focused on additional savings and one-time spending, and has warned legislative Democrats not to build new on-going government programs. **Legislative Democrats will find it difficult to show restraint, which is what caused the state's past budget troubles.**

One-time Spending the Right Approach but Could Be Better Targeted. One strategy for avoiding painful cuts in response to a future recession is to spend volatile revenues on one-time priorities that do not lock the state into future obligations. The Governor's budget proposes to allocate $4 billion dollars of surging General Fund revenues to one-time projects and priorities, as follows:

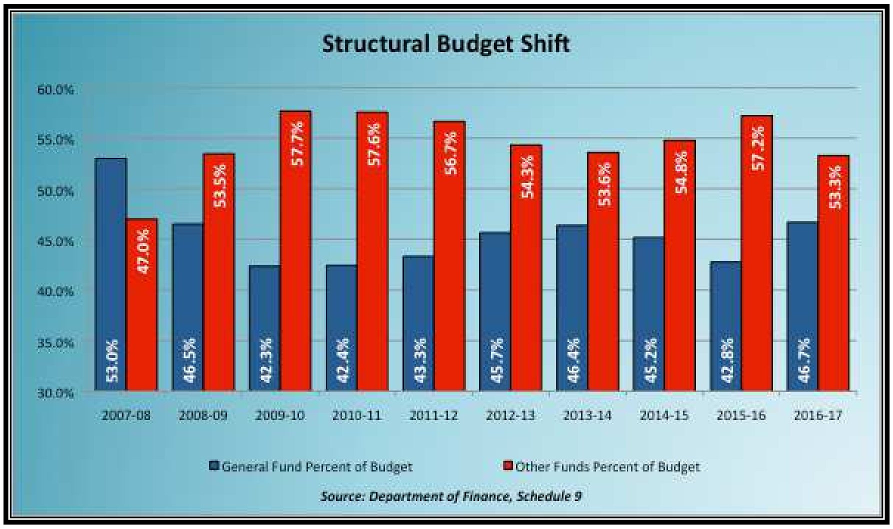
- Although it's not technically an "expenditure," the Governor proposes to deposit an additional $2 billion General Fund into the Proposition 2 rainy day fund for use at a future date. The revised calculations for Proposition 2 deposits can be found on ***page 11***. *This proposal is right in line with Senate Republican fiscal priorities to continue building a reserve that will help ease the burden of painful cuts during the next economic recession.*
- $500 million General Fund would be allocated to address deferred maintenance needs across a wide variety of state departments, ranging from the Community Colleges to the Departments of Parks and Recreation and Veterans Affairs. This proposal is consistent with a similar proposal included in last year's budget.
- $1.5 billion General Fund would be appropriated to fund pay-as-you-go Sacramento infrastructure projects to improve the safety and capacity of the Capitol Annex building and to address infrastructure deficiencies in new and existing state office buildings around the capitol. The Department of Finance indicates that the pay-as-you-go funding approach will allow the state to avoid an estimated $1.3 billion of interest and related bond administration costs, proceed more quickly with construction schedules, and incorporate more mixed use into these projects. **Pay-as-you-go is a commendable approach to infrastructure projects, but with all the infrastructure needs around the state, it is questionable whether several projects that benefit Sacramento alone are the highest priority.** *Senate Republicans are prioritizing building and restoring roads and water systems around the state so that all Californians can once again rely on these community essentials*.

Total Spending. The chart below also demonstrates how 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 $271.3 billion, decreasing to $262.6 billion in 2016-17. Even with the Great Recession, 2016-17 would be only the second time in nearly two decades that total state spending would decrease year over year. Much of the total spending decline is associated with a drop in federal funding within Health programs that does not result in a decrease in services or any program cuts.



Also note the black line in the chart, which represents how much California would spend on state programs had it been limited to population and inflation growth. In 2016-17, the state will spend nearly $62 billion more than population and inflation growth would dictate.

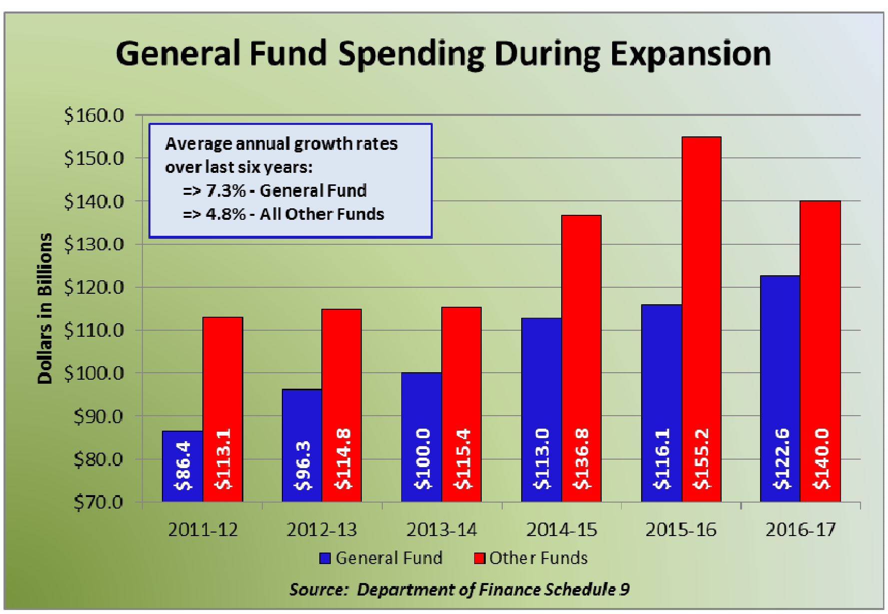
General Fund No Longer Majority of Spending. Prior to the recent budget crisis, the General Fund was the predominant fund for financing state government programs. However, as the chart below demonstrates, other funds (federal, special, and bond funds) have now become the primary sources for state spending. Prior to the most recent budget crisis, 53 percent of state spending came from the General Fund, but now it is less than 47 percent. During the recession, **this shift allowed legislative Democrats and others to claim state spending had been slashed when in fact it grew dramatically as other fund increases offset some General Fund program reductions**.



Furthermore, since the Legislature, the press, and the public tend to focus on the General Fund, the growth in other fund spending has occurred with scant oversight or attention. It is a sly way to grow spending while appearing fiscally austere and responsible. *Senate Republicans are committed to holding government accountable to the people by fighting for transparency on this and other issues.*

Since this structural shift occurred in response to the Great Recession and has not been reversed during the last six years of budgetary growth, the state will have fewer options to shift costs from the General Fund to other funds to cushion a future recession.

Strong Spending Growth During Recovery. Very few individual Californians have been able to increase their spending by 4.8 percent (much less by 7.3 percent) each year over the past six years. Yet, the state government continues to do it year after year, as shown in the chart below. A potential recession would likely curb these growth rates, but in the interim *Senate Republican want to empower California's workers with the skills and opportunities to find and keep quality jobs that will allow them to pay the bills and put food on the table for their families.* +



Revenues

The 2016-17 Governor's Budget continues to forecast strong revenue growth throughout the three-year forecast period. The budget estimates total General Fund revenues and transfers of $120.4 billion in 2015-16, increasing to $124.2 billion in 2016-17 (before transferring any money to the Rainy Day Fund as required by Proposition 2 of 2014). These estimates are slightly stronger than estimates provided by the Legislative Analyst's Office (LAO) in its November 2015 *Fiscal Outlook*.

<u>Quick Facts on General Fund Revenues:</u>

- Total General Fund revenues are projected to be cumulatively $5.9 billion higher than forecasts prepared for the 2015 Budget Act last June, as shown in the chart below.
- General Fund revenues grow by 6.6 percent to $120.4 billion from 2014-15 to 2015-16, and by 3.2 percent to $124.2 billion in 2016-17.
- General Fund revenues for 2016-17 are about $21.6 billion (21 percent) higher than the pre-recession revenue peak of $102.6 billion in 2007-08.
- Revenues continue to rely significantly on highly volatile personal income tax (PIT) growth that is linked to changes in capital gains income. In 2016-17, the PIT is estimated to contribute nearly 67.5 percent of all General Fund revenues. Capital gains alone would account for 10 percent of General Fund revenues.

Total Revenues and Transfers	2015 Budget Act	Governor's Budget	Forecast Change	%△
2014-15	$112,913	$112,924	$11	0.0%
2015-16	$116,887	$120,386	$3,499	3.0%
2016-17	$121,791	$124,189	$2,398	2.0%
Change to Estimate over 3-year Window			**$5,908**	

Source: Governor's Budget Summary

This record-setting revenue proves that California does not have a revenue problem, and the government's priorities can be funded without extending or raising taxes. Even with Proposition 30 income taxes expiring in 2019, the Governor continues to forecast 5.5 percent base revenue growth in 2019-20 (see *Revenues Grow Without Proposition 30* chart on the next page).

Personal Income Tax Drives Revenue Growth. The Department of Finance estimates a $6.5 billion increase over the three-year PIT forecast, which is being driven by higher capital gains forecasts and higher tax receipts from wages. PIT revenues of $83.8 billion in 2016-17 equates to nearly 67.5 percent of total revenues projected in that year.

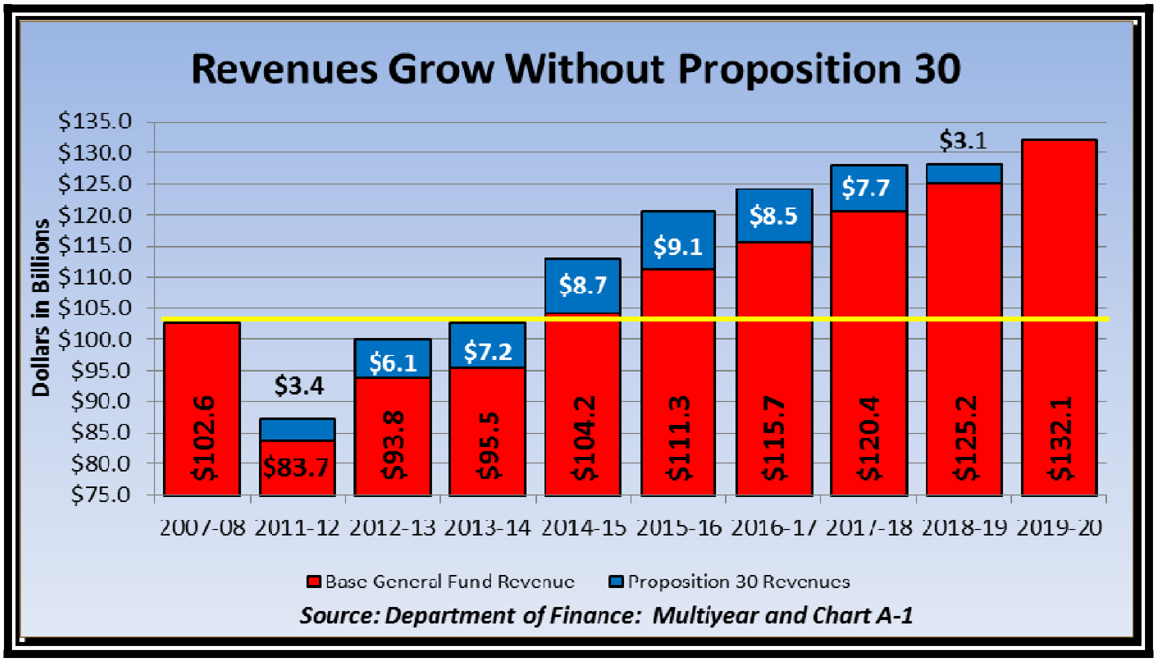
Personal Income Tax	2015 Budget Act	Governor's Budget	Forecast Change	%△
2014-15	$75,384	$76,079	$695	0.9%
2015-16	$77,700	$81,354	$3,654	4.7%
2016-17	$81,652	$83,841	$2,189	2.7%
Change to Estimate over 3-year Window			**$6,538**	

Source: Governor's Budget Summary

The main focus of the Governor's budget press conference, however, was to highlight the fact that these revenues have historically been highly volatile, and the state's over-reliance on capital gains in particular has been a leading factor contributing to boom-and-bust budgeting.

Proposition 30 Revenues Should Expire As Promised. In 2012 voters approved Proposition 30 as a temporary way to shore up state finances. The quarter cent sales and use tax is scheduled to expire January 1, 2017, and the tax increase on high-income earners is scheduled to expire January 1, 2019.

One concern that some Democrats have raised is that when the Proposition 30 tax increases expire, the state will experience a "cliff effect" on revenues that will not be able to sustain state spending. As demonstrated in the following chart, however, it is clear that the Proposition 30 taxes are not necessary to keep revenues growing. In fact, **those tax increases are simply providing a new revenue windfall for the state treasury at the expense of hard-working California families**.



Given the strength of the Governor's revenue projections, extending the Proposition 30 tax increases, or making them permanent, is not necessary. Based on Department of Finance projections, even with the expiration of these taxes, total General Fund revenues in 2019-20 will outpace revenue collections in the prior year by $3.8 billion ($29.5 billion more than the pre-recession peak of $102.6 billion in 2007-08). To his credit, the Governor is not proposing to extend the temporary taxes. *Allowing these taxes to expire as promised is consistent with Senate Republicans' priority to respect the voters through responsible government.*

Governor's Revenues a Solid Starting Point for Budget Deliberations. The LAO indicates that, "As the administration's key tax projections are similar to our most recent estimates, we believe the Legislature can feel comfortable using them as they begin budget deliberations." Consistent with the Governor, the LAO also implores the Legislature to exercise caution in building its budget, stating, "By May, normal stock market volatility and relatively modest changes in the direction of the economy and tax collections could easily increase or decrease 2015-16 revenue estimates by a billion or two, and similarly, 2016-17 revenue estimates could easily go up or down by $3 billion or $4 billion."

Proposition 2 Rainy Day Fund

In November 2014, California voters overwhelmingly approved Proposition 2 to establish meaningful Rainy Day Fund (RDF) requirements in the state constitution. The Governor's budget makes real progress in building a reserve that will help ensure that taxpayers and key programs are protected from California's boom-and-bust revenue cycles.

As summarized in the table below, the budget would transfer $1.6 billion to the RDF and allocate $1.6 billion for debt reduction, as required by Proposition 2. Over the next four years these annual transfers are projected to reach $4.8 billion each for RDF deposits and debt reduction. Notably, 80 percent or nearly $7.7 billion of these combined amounts results from the up-front 1.5 percent set-aside that Republicans negotiated in the development of Proposition 2. As shown in the table, the up-front contribution is a more stable source for the RDF than the capital gains contribution, which the Governor projects would decline to zero by 2019-20.

Rainy Day Fund Forecast
Dollars in Millions

	2016-17	2017-18	2018-19	2019-20	Total
Annual 1.5% of General Fund Revenues	$1,863	$1,922	$1,925	$1,982	**$7,692**
Capital Gains Taxes in Excess of 8% of General Fund Revenues	$1,249	$646	$72	$0	**$1,967**
Rainy Day Amounts Available	**$3,112**	**$2,568**	**$1,997**	**$1,982**	**$9,659**
Required Debt Repayment (50%)	$1,556	$1,284	$999	$991	**$4,830**
Required Deposit to Rainy Day Fund (50%)	$1,556	$1,284	$999	$991	**$4,830**
Additional Rainy Day Fund Deposit	$2,000	$0	$0	$0	**$2,000**
Rainy Day Fund Balance at End of Year [1]	**$8,011**	**$9,295**	**$10,294**	**$11,285**	
Balance as % of General Fund Revenue	**6.5%**	**7.3%**	**8.1%**	**8.6%**	

1. Includes beginning balance of $4.5 billion from previous years' deposits.

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

Source: Department of Finance, January 2016

Governor's Additional Savings Make Sense. The Governor proposes a $2 billion deposit beyond the required amount, which would bring the 2016-17 RDF balance to about $8 billion, or 6.5 percent of General Fund revenue. Senate Republicans agree that it makes sense to save additional funds beyond the minimum requirement. Without this additional deposit, the RDF balance would be 4.8 percent of revenue, which is likely inadequate considering that California's economic expansion may be nearing its end. Even with the extra deposit, the RDF balance would only reach 8.6 percent of revenue by 2019-20, still less than the constitutional limit of 10 percent. The Governor also proposes to increase the unrestricted, non-RDF reserve to $2.2 billion. Legislative Democrats are likely to view both this unrestricted reserve and the extra $2 billion RDF deposit as potential spending sources.

The Administration has indicated that the supplemental $2 billion deposit would be protected by Proposition 2's standard withdrawal limitations, which would prevent legislative Democrats from spending these funds except in fiscal emergencies. *Senate Republicans will seek to ensure that all RDF deposits are truly protecting against downturns. This is consistent with the priority of respecting the voters through responsible government*.

Judiciary

Proposition 47 Workload

Proposition 47 (2014) reduced many drug and property crimes from felonies to misdemeanors and allowed individuals convicted of those former felonies to petition the courts for resentencing as misdemeanors. The resentencing provision resulted in a temporary workload increase for the trial courts. The Budget Act of 2015 provided about $27 million General Fund on a one-time basis to address the increased workload. The Governor's budget includes $21.4 million General Fund in 2016-17, again on a one-time basis, for the second year of Proposition 47 resentencing workload. The Administration expects that the vast majority of the remaining resentencing work will be completed in 2016-17.

Increased Funding for the Trial Courts

The 2016-17 Governor's Budget would continue the reinvestment in the state's trial courts that began in 2013-14, following a string of reductions to the trial courts' budget during the Great Recession, by providing $226.3 million in additional General Fund support. Of this amount, $169.3 million would go toward the increasing costs of maintaining existing levels of service. The rest would be for new programs, expanded services, and trial court operational needs. Funds would be allocated as follows:

Maintaining Existing Levels of Service

- $75 million one-time to backfill a shortfall in the Trial Court Trust Fund (TCTF) due to lower-than-projected revenues from court user fees. The 2015-16 backfill was just over $66 million.
- $60 million one-time to address deferred maintenance in the courts. This is part of a broader proposal to provide $807 million for deferred maintenance at various state agencies.
- $15.6 million to cover increased trial court employee retirement and health benefit costs.
- $10 million one-time to establish a permanent state-level reserve in the TCTF while allowing each trial court to receive its full base allocation earlier in the year, eliminating the current two-percent holdback policy.
- $8.7 million to permanently shift funding for the courts' statewide Phoenix Financial System from the State Trial Court Improvement and Modernization Fund (IMF) to the General Fund. The IMF, which is intended to support improvements to court information technology systems, currently has a structural imbalance and will soon be insolvent. This fund shift is part of a multipronged plan to maintain the IMF's solvency.

New Programs, Expanded Services, and Operational Needs

- $30 million for competitive grants to encourage courts to develop innovative business practices that have measurable results and positive impacts on the court and the public it serves.
- $20 million in discretionary trial court operations funding.
- $7 million to expand court interpreter services in civil proceedings.

The Governor's proposal certainly offers some relief for the courts. However, given the Chief Justice's 2014-15 *Three-Year Blueprint for a Fully Functioning Judicial Branch*, which sought $1.2 billion in additional funding over three years to make the Judicial Branch "whole," the courts will be looking for substantially more funding than the Governor is proposing for 2016-17. If the Governor's plan is adopted, some courts will likely face additional reductions in service to live within their budgets. *Senate Republicans believe that additional funds are necessary to meet the priority of keeping our communities safe by providing sufficient resources to trial courts and local law enforcement agencies.*

Retirement

<u>California State Teachers' Retirement System (CalSTRS)</u>

Plan to Address Liabilities Significantly Increasing State Costs. The Governor's budget includes $2.5 billion General Fund for CalSTRS, an increase of $533 million General Fund and 28 percent above the 2015-16 Governor's Budget. **Total 2016-17 contributions to CalSTRS are projected to be about $9.4 billion** from all three funding sources (school districts, teachers, and the state). The recent funding plan for CalSTRS (approved as part of the 2014 Budget Act) will address the $72.7 billion unfunded liability, with contribution increases phased in over the next few years for schools, teachers and the state. By 2020-21 the contribution increases will be fully phased in, and **funding from all three sources should be about <u>$13 billion annually</u> and growing.**

<u>California Public Employees Retirement System (CalPERS)</u>

Public Employee Pension Costs Continue to Rise. The Governor's budget provides $5.5 billion ($3.2 billion General Fund) for contributions to CalPERS for retirement costs of state employees, including California State University employees. This is an 11 percent increase over 2015-16 ($542.6 million total funds, $305 million General Fund). Although the cost increases projected for the next few years are significant (five percent growth each year), the future cost to taxpayers could be even higher if investment returns are lower than projected. The 7.5 percent return assumed by CalPERS is considered to be unrealistically high, and could lead the state to underfund future General Fund pension costs. This could result in the need for higher General Fund contributions in the future, which could in turn limit the state's ability to provide education, public safety, and health and safety net services.

Pension Reform Savings Modestly Reduce Unfunded Liability. The Governor's budget includes savings as a result of the passage of AB 340, the Public Employees' Pension Reform Act of 2013 (PEPRA), which provided lower pension benefits and required higher retirement ages and higher contributions from state employees. The 2016-17 Governor's Budget includes savings of $109.8 million ($74.8 million General Fund) as a result of PEPRA, and the entire amount is required to be contributed to the state's unfunded pension liability, estimated to be $43.3 billion as of December 31, 2015.

<u>Retiree Health Care Benefits</u>

The Governor's budget includes $5.2 billion ($3.6 billion General Fund) for health care benefits for more than 800,000 state employees, retirees, and their family members. Expenditures for 2016-17 are nearly $400 million (8 percent) higher than 2015-16. Of the $5.2 billion, $2.0 billion General Fund is for state retiree health care benefits in 2016-17.

The state continues to provide retiree health care benefits with a "pay-as-you-go" system, an approach that has led to the state's current $74.1 billion unfunded liability. Without action, the state's unfunded liability could grow to $100 billion by 2020-21 and $300 billion by 2047-48. The latest bargaining unit agreement included provisions for equal cost sharing in the prefunding of retiree health benefits between the state and employees, similar to how the state funds pension benefits. The Administration intends to seek similar cost-sharing agreements as part of the current labor contracts. Retiree health benefit costs are one of the fastest growing areas of the budget, and will continue to require increasing amounts of General Fund dollars. This will crowd out other spending priorities like education and public safety and could limit the state's ability to access capital markets to finance needed projects, such as the projected $66 billion in deferred maintenance on existing state infrastructure. *Senate Republicans believe that more should be done to prefund these benefits and reduce the state's outstanding retiree obligations*, as discussed further in the *Statewide Debts and Liabilities* section on page 43.

Education

Proposition 98 funding for K-14 education continues to surge. Total Proposition 98 education funding reaches an all-time high of nearly $71.6 billion in 2016-17, and average per pupil K-12 spending grows to about $10,600.[1] More specifically, as the chart below shows, Proposition 98 spending across the past and current fiscal years rises by over $1.1 billion from the amounts assumed in the 2015-16 Budget Act (by $388 million in 2014-15 and $766 million in 2015-16), and 2016-17 spending rises by another $2.4 billion beyond the revised current-year level.

Proposition 98 Funding at 2016-17 Governor's Budget

Source: Legislative Analyst's Office

($ in millions)

	2014-15 at 2015-16 FBA 2/	2014-15 at 2016-17 GB 3/	change	2015-16 at 2015-16 FBA	2015-16 at 2016-17 GB	change	2016-17 GB	change from revised 2015-16
K-12 education 1/								
General Fund	$44,552	$44,496	-$56	$44,035	$44,536	$501	$45,442	$906
Local property tax revenue	$14,432	$14,834	$402	$16,380	$16,560	$180	$17,802	$1,242
K-12 subtotal	$58,984	$59,330	$346	$60,415	$61,096	$681	$63,244	$2,148
California Community Colleges 4/								
General Fund	$4,975	$4,979	$4	$5,300	$5,373	$73	$5,447	$74
Local property tax revenue	$2,263	$2,302	$39	$2,613	$2,624	$11	$2,812	$188
CCC subtotal	$7,238	$7,281	$43	$7,913	$7,997	$84	$8,259	$262
Other Agencies	$80	$80	$0	$80	$82	$2	$83	$0
Total Proposition 98 5/	$66,302	$66,690	$388	$68,409	$69,175	$766	$71,585	$2,410
General Fund	$49,607	$49,554	-$53	$49,416	$49,992	$576	$50,972	$980
Local property tax revenue	$16,695	$17,136	$441	$18,993	$19,183	$190	$20,613	$1,430

1/ K-12 education totals include state preschool and related 'wraparound care'

2/ FBA = final budget act

3/ GB = Governor's proposed budget

4/ 2015-16 and 2016-17 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

Education mandate debt falls. The Governor's budget proposes funding to reduce the backlog of unpaid K-14 education mandate claims by $1.4 billion ($1.3 billion for K-12 schools and $76 million for community colleges), to about $1.8 billion by the end of 2016-17. These one-time funds may be used to support implementation of new content standards, technology, teacher induction and professional development programs, deferred maintenance, or any other locally-determined need. *This debt reduction effort is consistent with the Senate Republican priority of respecting the voters through responsible government.*

Local Control Funding Formula (LCFF) grows to 95% of target level. The state's local control funding formula for K-12 schools will enter its fourth year of implementation in 2016-17. Under the formula, local educational agencies (LEAs) receive:

- Per-pupil base grants based on average daily attendance, according to grade span (K-3, 4-6, 7-8, and 9-12), with base rates enhanced for grades K-3 (by 10.4 percent) and grades 9-12 (by 2.6 percent).

[1] Per-pupil spending varies widely across the state under the Local Control Funding Formula, which provides substantially more funding to districts with high proportions of low-income students.

- Supplemental grants worth an additional 20 percent of base grant funding for each low-income student,[2] English learner, or foster youth.[3]
- Concentration grants worth an additional 50 percent of base funding for these same students, to the extent that they exceed 55 percent of an LEA's total enrollment.

The Governor's 2016-17 budget provides an augmentation of over $2.8 billion, bringing locally-controlled funding to about $55.5 billion, roughly 95% of the statewide target level. *Senate Republicans have supported additional LCFF funding based on its enhancement of local control.*

Career technical education (CTE) funding preserved and enhanced. In an effort to ensure that K-12 CTE programs continued after a two-year maintenance-of-effort requirement ended in June 2015, the 2015-16 budget included a new transitional CTE incentive grant program funded at $900 million over three years. The Governor's budget proposal funds the second year of this effort as planned, at $300 million. In addition, it maintains funding of $4.1 million for agricultural education incentive grants and $4.9 million for specialized secondary programs, both of which were threatened when the Governor proposed to eliminate them as stand-alone categorical programs in 2014-15. Another $248 million is provided for community college CTE programs, as outlined later in this section. *Support for career technical education is consistent with the Senate Republican priority of building new career paths for today's economy.*

Preschool programs restructured. The Governor's budget proposes to create a new Early Education Block Grant focused on low-income and at-risk preschoolers (four-year-olds and young five-year-olds) by consolidating existing funding for State Preschool ($878 million), Transitional Kindergarten ($726 million), and the State Preschool Quality Rating and Improvement System ($50 million) into a single, more flexible and locally-controlled funding stream. Program specifics will be developed through a stakeholder process in spring 2016. The proposal's expansion of local control is attractive, but care should be taken to ensure that the number of children served does not fall to make room for higher provider rates.

Child care vouchers would expand. In addition, the Administration proposes to transition child care funding to a completely voucher-based system over the next five years in order to increase efficiency and access to care during non-traditional hours, such as nights and weekends. Currently, over two-thirds of child care is provided through vouchers, while the remainder is offered through contracts with child care centers that receive guaranteed funding for daytime slots. Families would likely welcome the additional flexibility available through more vouchers, and they would continue to be able to use their vouchers at child care centers, just as they can now, if they prefer a center-based setting.

Fiscally irresponsible local budget reserve restrictions remain. The 2014-15 education budget trailer bill imposed unfortunate new restrictions on schools' ability to grow and maintain healthy rainy-day reserves to insulate themselves from both known and unplanned fiscal pressures.[4] The restrictions are not in effect now, but would be triggered if the state were ever to make a deposit into the Proposition 98 reserve established by Proposition 2 of 2014. The 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. The restrictions have been condemned by every major education advocacy group in the state, with the exception of the teachers' unions. Senate Republicans vehemently opposed the restrictions based on their fiscal imprudence and potentially disproportionate impact on schools with high populations of low-income students, English learners, and foster youth who depend more heavily on the support provided by schools. Were the restrictions ever to become operative, they could wipe out most of the resources set aside by prudent districts for future costs such as their growing share of pension contributions, major textbook adoptions,

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

large technology purchases, etc. Unfortunately, the Governor's 2016-17 budget makes no proposal to unwind them. *Senate Republicans continue to support efforts such as that of SB 774 (Fuller, 2015) to repeal these highly-objectionable restrictions.*

Alternative school facilities bond proposed. The Governor objects to the $9 billion school facilities bond that recently qualified for the November 2016 ballot, based on its cost, complexity, and lack of flexibility. The Administration proposes to negotiate a less costly alternative that would 1) focus state funding only on districts with exceptional need, 2) enable other districts to raise their own resources by increasing statutory caps on local bond debt by the rate of inflation, 3) restructure developer fees, and 4) expand allowable uses of routine restricted maintenance funding.[5]

Charter school funding grows. The Governor's budget includes $61 million for growth in charter school average daily attendance and $20 million in one-time funding for charter school startup costs to backfill the loss of a federal grant that previously served a similar function. Senate Republicans have been generally supportive of charter schools, which provide alternatives for families dissatisfied with traditional government schools.

Proposition 47 school funding commences. Proposition 47, approved by the voters in 2014, reduced penalties for certain property and drug offenses, and required that a portion of any resulting state savings be spent for specified purposes, including K-12 education programs. The Governor's 2016-17 budget proposes to commence this funding with $7.3 million to reduce truancy and support students who are at risk of dropping out of school or are victims of crime. Because the funds will be spent directly on students, the Administration scores them in satisfaction of the state's Proposition 98 guarantee of funding for K-14 education.

Proposition 39 energy efficiency funding rises. The Governor's proposed budget provides a total of $411 million for Proposition 39 energy efficiency projects at K-12 schools ($365 million) and community colleges ($45 million), up from a total of $352 million in 2015-16.

[5] More detail is provided starting on page 50 here: http://www.ebudget.ca.gov/2016-Infrastructure-Plan.pdf

Higher Education

The Governor's budget includes substantial new investments in community colleges, while providing more modest increases for University of California (UC) and California State University (CSU) through continued implementation of a four-year plan that began in 2013-14. The following chart displays the Governor's proposed funding for the state's three segments of higher education, details of which are discussed on the following pages.

UC, CSU, and CCC Funding at 2016-17 Governor's Budget

(Core funds, in millions)

	Fund	2014-15	2015-16	2016-17
UC	General Fund [1,2,3/]	$2,993	$3,257	$3,467
	Tuition and Fees [4/]	3,998	4,112	4,300
	Other UC Core Funds [5/]	240	240	240
	Lottery	32	33	33
	Total UC	**$7,263**	**$7,642**	**$8,039**
CSU	General Fund [1,2,3,6/]	$3,042	$3,297	$3,484
	Tuition and Fees [4/]	2,905	2,929	2,956
	Lottery	55	51	51
	Total CSU	**$6,002**	**$6,277**	**$6,491**
CCC	General Fund [1,3,8/]	$5,366	$5,813	$5,971
	Student Fees [7/]	410	420	426
	Local Property Tax	2,302	2,624	2,812
	Lottery	189	202	202
	Total CCC	**$8,267**	**$9,059**	**$9,411**
	Total -- all segments	**$21,532**	**$22,977**	**$23,940**

[1/] Includes general obligation bond debt service.

[2/] For 2016-17, includes $35 million one-time funds for deferred maintenance.

[3/] For 2014-15 and 2016-17, includes Awards for Innovation in Higher Education.

[4/] Includes systemwide fees (before discounts and waivers) and nonresident tuition.

[5/] Includes application fees, interest, and a portion of grant overhead and patent royalty income.

[6/] Includes funding for CSU retired annuitant health care costs from another budget item.

[7/] Includes fees actually collected. CCC Board of Governors fee waivers are required by statute and are offset by General Fund support under Proposition 98.

[8/] Includes CCC CalSTRS contributions paid from non-Proposition 98 General Fund.

Source: Legislative Analyst's Office

California Community Colleges (CCCs). Under the Governor's budget proposal, the Community Colleges' share of Proposition 98 funding rises by $43 million in 2014-15, $84 million in 2015-16, and another $262 million beyond the adjusted 2015-16 level in 2016-17, to $8.26 billion.[6] The most significant new proposals include:

- $200 million for "Strong Workforce" education programs.
- $48 million to continue the Career Technical Education Pathways Program, formerly funded through the expired Quality Education Investment Act, which supports collaboration between schools, community colleges, and local employers to improve career pathways and linkages.

[6] CCC funding includes $500 million for adult education, which can flow to any K-14 education agency.

- $30 million to expand the Basic Skills Initiative to assist unprepared students to successfully transition to college-level math and English coursework.
- $25 million in one-time incentive funding for Innovation Awards focusing on technology and data, transfer pathways, and successful transitions from higher education to the workforce.

All of these proposals are consistent with Senate Republicans' priority of building new career paths for today's economy.

In addition to the funding for mandates, energy-efficiency, and workforce training discussed earlier in this section, other notable adjustments in the colleges' budget include:

- $283 million in one-time funding for deferred maintenance and instructional equipment.
- $115 million for two percent enrollment growth.
- $29.3 million for a 0.47 percent cost-of-living adjustment to apportionment funding.
- $10 million for the Institutional Effectiveness Partnership Program, which assists CCC districts that are struggling with issues related to student performance, accreditation, fiscal viability, or compliance with state and federal requirements.
- $5 million in one-time incentive funding for development of degree programs that impose no costs on students for the use of textbooks.
- $3 million for data security.
- $1.8 million for apprenticeship programs, reflecting the 2015-16 increase in the state rate paid for enhanced non-credit instruction.
- $1.3 million for various categorical program cost-of-living adjustments.

University of California (UC). Consistent with the 2015-16 enacted budget, the Governor's budget proposal for UC assumes that it will enroll 5,000 more resident undergraduates in 2016-17 than it did in 2014-15, for which it will receive a $25 million ongoing augmentation beginning in 2015-16. In addition, the Governor's proposal includes the following augmentations for 2016-17:

- $125 million for a four percent increase in General Fund support. This is consistent with the "5-5-4-4" plan launched in 2013-14 to give UC specific General Fund increases over four years.
- $171 million in one-time Proposition 2 Rainy Day funds to pay down the UC Retirement Plan's unfunded liability. The funds will be released only if the UC Regents establish a pension plan no later than June 30, 2016, that limits pensionable earnings for new employees to the same level included in the Public Employees' Pension Reform Act of 2013 (about $117,000 for employees participating in Social Security, and about $140,000 for non-participants). Although the state has recently contributed to the UC retirement plan, it is under no legal obligation to do so.
- $35 million in one-time funding for deferred maintenance.
- $25 million in one-time Cap and Trade funding for energy projects.

UC resident undergraduate tuition continues unchanged at $11,220. However, its student services (registration) fee will rise by five percent in 2016-17, from $1,020 to $1,074.

California State University (CSU). The Governor's 2016-17 budget proposal provides the same $125 million augmentation for CSU as for UC, consistent with the "5-5-4-4" plan. In addition, the budget augments CSU's budget by:

- $35 million in one-time funding for deferred maintenance.
- $35 million in one-time Cap and Trade funding for energy projects.

- $15 million in general-purpose funding from savings generated by changes made to the Middle Class Scholarship program in 2015-16.
- $7.9 million for lease-revenue bond debt service.

CSU resident undergraduate tuition continues unchanged at $5,472 in 2016-17.

Student financial aid grows. The Student Aid Commission's budget for grants, student loan assumption programs, and outreach activities grows in 2016-17 to almost $2.3 billion, with augmentations of $89 million for Cal Grants and $34 million for the Middle Class Scholarship program. The Governor proposes to add another $305 million in federal Temporary Assistance for Needy Families (TANF) funding for student financial aid, bringing total TANF funding to $826 million and offsetting an identical amount of General Fund support.

Consistent with the priority to build new career paths for today's economy, Senate Republicans support funding for higher education at a level sufficient to ensure that every qualified California student is admitted and can access the coursework necessary to graduate in four years. Funding enhancements should be used to admit more students and better serve them, not merely to expand the segments' administrative structures nor increase already-inflated executive compensation.[7]

[7] For example, 16 staff in one office alone (UC's Office of the President) already earn more than the Governor's salary of about $183,000. http://www.dof.ca.gov/budget/historical/2015-16/salaries_and_wages/

Health

Medi-Cal

The Governor's budget proposes Medi-Cal General Fund spending of $17.6 billion in 2015-16 and $19.1 billion in 2016-17, an increase of 8.2 percent. Key changes and policies are discussed below.

Managed Care Organization (MCO) Revenues Not Budgeted. The Governor assumes that a revised version of the MCO funding package will be enacted, but the Medi-Cal budget does not reflect any expenditures or General Fund savings from MCO revenues. The MCO issue is discussed in more detail under *Managed Care Funding* on page 23.

Health Reform Costs and Enrollment. The expansion of Medi-Cal eligibility associated with the federal Affordable Care Act (ACA) became effective January 1, 2014. Key effects of the ACA on Medi-Cal include enrollment increases of 8.0 percent in 2015-16 and 1.5 percent in 2016-17. Enrollment in 2016-17 would reach 13.5 million, an expansion of 5.6 million enrollees since 2012-13 (including some non-ACA growth). **Following this enrollment explosion, Medi-Cal now covers roughly one-third of the California population.**

Beginning in 2016-17, California will now be required to pay a share of cost for the "optional expansion" to adults under the ACA. The state's initial 5 percent share of this population's costs begins January 1, 2017 and will amount to $740 million General Fund for the half year. The state share will increase to 10 percent by 2020, when it may reach $2 billion or more. Additionally, continuing problems implementing the ACA eligibility information system will result in new costs of $57 million General Fund in 2016-17, adding to the hundreds of millions in taxpayer dollars already wasted due to the troubled roll-out of the system.

Provider Rate Restorations Missing. The Governor's budget estimates the savings from the previously enacted 10 percent reductions to be $189 million General Fund in 2016-17. Despite bipartisan efforts to restore the rates in 2015, the budget maintains the reductions. Continuing down this path at the same time that Medi-Cal enrollment expands to one-third of California's population will result in a program that does not work well either for care providers or the people who depend on them. *Restoring rates to help improve access to care for Medi-Cal patients is consistent with Senate Republicans' priority to keep our promises to those with the greatest needs.*

Full-Year Implementation of Undocumented Minor Expansion. The 2015-16 budget expanded eligibility for full Medi-Cal benefits to undocumented minors who meet all other income requirements. This expansion is set to take effect May 1, 2016, and is now projected to cost $143 million General Fund in 2016-17 to enroll 170,000 minors.

Human Services

CalWORKs, Supplemental Security Income/State Supplementary Payment (SSI/SSP), In-Home Supportive Services (IHSS), Child Welfare Services, and CalFresh provide cash assistance and other services to Californians with low incomes or other qualifying conditions. The chart below summarizes proposed changes in the Governor's budget for these programs.

Summary of Program/Department Expenditures

Dollars in Millions

	Total Funds				General Fund				
	2015-16	2016-17	Change		2015-16	2016-17	Change		
Program/Dept	Revised Budget	Jan Budget	$	%	Revised Budget	Jan Budget	$	%	Key Changes from 2015-16
CalWORKs	$5,423	$5,227	($196)	(4)%	$621	$656	$35	6%	*Caseload decreasing 5.5% from 2015-16
SSI/SSP	$10,049	$10,300	$251	2%	$2,795	$2,873	$78	3%	*Adds $41 million General Fund for 3% cost-of-living adjustment to the state SSP portion of the grant, eff. January 1, 2017.
In-Home Supportive Services	$9,627	$10,419	$792	8%	$2,934	$3,202	$268	9%	*Federal FLSA overtime rules add $392 million General Fund in 2016-17. *$10 minimum wage adds $37 million General Fund Jan 1, 2016.
Child Welfare Services	$5,471	$5,674	$203	4%	$115	$156	$41	36%	*Continuum of Care Reform (CCR) continues, adds an additional $27.1 million General Fund for CCR activities.
CalFresh	$9,971	$10,485	$514	5%	$693	$715	$23	3%	*Adds $18.4 million General Fund for food assistance program as part of Drought Assistance package. *Caseload up 6.6% in 2016-17

Supplemental Security Income/State Supplementary Payment (SSI/SSP)

Cost of Living Adjustment. The 2016-17 budget includes a 2.96% cost of living adjustment to the state portion of the SSI/SSP grants (the first since 2006), an increase of $80 million General Fund upon full implementation. Individuals enrolled in the program would receive $17 more each month, and couples would receive $31 more each month. *Senate Republicans have made a commitment to "keeping our promise to those with the greatest needs," and this proposal is a reasonable step for those aged, blind and disabled Californians that no longer have an opportunity to work and provide for themselves.*

The chart on the following page details the grant amounts, including grants for the Cash Assistance Program for Immigrants (CAPI). See below for CAPI program information.

Average Monthly Grants		2015-16 Budget	2015-16 Revised	2016-17
SSI/SSP	Aged	$518.08	$511.94	$519.23
	Blind	$665.64	$669.79	$669.79
	Disabled	$664.19	$662.36	$670.30
CAPI	Person	$761.22	$763.85	$771.79

Cash Assistance Program for Immigrants. The CAPI was established in 1998 as a 100 percent state General Fund program to provide cash benefits to aged, blind, and disabled non-citizens who were not eligible for the federal SSI/SSP program. There are currently about 15,100 non-citizens receiving CAPI benefits in California. Any grant increases given to SSI/SSP recipients would also increase grants for CAPI recipients.

<u>In-Home Supportive Services (IHSS)</u>

IHSS, a Medi-Cal benefit that provides personal care and domestic services to 490,000 recipients, continues to be one of the state's fastest growing programs, with a nine percent increase in General Fund costs proposed for 2016-17. As noted in the Governor's Budget Summary, "General Fund costs in this program have doubled since 2010-11, while caseload has increased 12 percent." In over 70 percent of cases, recipients choose family members to be their paid providers. Although IHSS was originally sold as a way to keep frail individuals out of more expensive nursing homes, the program has evolved into serving significantly more than just those frail individuals and instead primarily supplements recipients' family incomes.

Overtime and the Fair Labor Standards Act (FLSA). The 2016-17 budget proposes a February 1, 2016 implementation of federal FLSA regulations that require the payment of overtime for domestic workers. The budget includes $845.9 million ($392.4 million General Fund) in 2016-17, and costs are likely to grow. Legislation enacted in 2014 limits providers to a 66-hour workweek, and Department of Social Services (DSS) has full responsibility for oversight and program integrity. It will be critical for DSS to provide guidance to counties while maintaining oversight of the program's new requirements in order to ensure strict accountability and compliance with the overtime limits.

Proposed Managed Care Tax to Restore IHSS Hours. The Governor's budget continues to assume revenue from the managed care organization (MCO) tax (see *Managed Care Funding* on page 23 for additional information) would offset the cost to restore the seven percent reduction to IHSS service hours, at a cost of $507.3 million ($236.2 million General Fund) in 2016-17. The 2015 Budget Act temporarily restored the seven percent reduction using General Fund for all the non-federal costs. *Senate Republicans have expressed concern with the rapidly growing costs of the IHSS program and the lack of strong program integrity resources*. Additionally, if the MCO tax is not approved, the state General Fund would be responsible for 100 percent of the $236 million non-federal cost. Counties will not share in any additional program costs due to the misguided maintenance-of-effort policy implemented in 2011-12 that capped the counties' IHSS costs at the 2011-12 level.

<u>Child Welfare Services</u>

Continuum of Care Reform. The 2016-17 budget includes $94.9 million ($60.9 million General Fund) for the DSS, county child welfare agencies, and county probation departments to continue implementing CCR reforms. The proposal to reform the state's residential care delivery system (foster care group homes) is much needed and should improve the state's delivery of services to our foster youth, including mental health services, counseling and independent living skills. *This proposal is consistent with Senate Republicans' priority to keep the state's promises to those with the greatest needs.*

Managed Care Funding

New Managed Care Organization (MCO) Funding Plan Proposed. The Governor assumes that a revised version of last year's MCO funding package will be enacted for 2016-17. The state's existing MCO tax will not meet requirements recently updated by the federal government. Under these new federal rules, the current tax would not be renewed after its expiration on June 30, 2016, because it only applies narrowly to Medi-Cal managed care plans. Key features and concerns are discussed below.

Expected Timing. The Governor has indicated he intends to seek enactment of the revised MCO funding package in an expedited manner through a policy bill as part of the existing 2nd Extraordinary Session for Health Care, prior to the normal budget process.

Key Features

- ***Billions in Net Revenue, but Overall Cost Reduction for Health Plans.*** The most recent information provided by the Administration indicates that the MCO package would raise $2.5 billion in MCO revenues, partially offset by $371 million in other tax reductions (see next paragraph). After adding federal funds to the mix, the Administration estimates the net effect on health plans as a group would be a cost reduction of $90 million. Net funds available to the state to potentially offset General Fund spending would be $1.35 billion.
- ***Some Tax Reductions Included.*** All health plans included in the proposal would pay some level of MCO tax that would vary by health plan size and type. However, the revised proposal also eliminates $371 million in existing Gross Premiums Tax and the Bank and Corporations Tax combined for health plans that would otherwise be subject to those taxes. In some cases, these eliminations, when combined with the federal funds received, may result a net financial gain for the health plan, despite the higher MCO tax.
- ***Most Health Plans Included.*** Similar to the 2015 proposal, the revised plan would apply to nearly all managed care plans regardless of whether they currently serve Medi-Cal or pay the current tax. This is intended to address the updated federal requirement that any funding assessment be broadly based. However, the revised proposal also excludes a handful of health plans that are smaller, regionally-focused plans.
- ***Greater Rate Predictability.*** The 2015 MCO proposal threatened to create market instability if enrollment in various health plans changed. Such changes could occur through health plan acquisitions or if certain health plans exited regional markets. The revised plan would base the MCO tax on a fixed point-in-time enrollment and then adjust the assessment amount by predetermined inflation rates each year. This feature helps address previous concerns about lack of predictability.
- ***Sunset Date.*** Unlike the prior year's plan, the revised edition would include a three-year sunset. This is the only feature that offers a modicum of assurance that Democrats would adhere to the originally enacted proposal.

Key Concerns

Despite improvements since the Governor's 2015 proposal, the revised package raises several key concerns and questions:

- ***Tax Increases Unnecessary.*** Although the 2016-17 budget assumes that a revised version of the MCO tax will be enacted, the MCO revenues and expenditures are not actually included in the Medi-Cal budget or in overall General Fund revenues. This demonstrates that the MCO proposal is not necessary to balance the budget. Only $236 million in MCO proceeds are built into the overall budget, in order to continue funding a prior year restoration to the In-Home Supportive Services (IHSS) program that Republicans did not support.

- ***Federal Approval Highly Uncertain.*** Federal approval of the MCO package is required, but the complexities added to the package create a substantial risk that it would not meet federal standards. However, the federal government will not evaluate the package until it has been enacted by state legislation and formally submitted. There is no way to know in advance whether any bill would actually pass muster.
- ***Differing Effects on Individual Health Plans.*** Although the Administration projects a net decrease for health plans as a group, the effect on individual plans continues to vary widely. Some health plans may benefit substantially, while other still face costs. This raises concerns about government intervention in the health insurance market.
- ***A $1 Billion Slush Fund?*** Due to California's healthy revenues, there is currently no "hole" in the Medi-Cal budget or in the overall General Fund budget. Backfilling $1.1 billion in Medi-Cal General Fund with MCO proceeds would thus only free up that same amount to be used anywhere in the state budget, creating a veritable slush fund for Democrats to use for their priorities. Once initial approval of a funding package is obtained, there is little that Republicans can do to direct use of the funds.
- ***Future Opportunities Remain.*** Uncertainty exists around California's economic future. However, even if the MCO funding package is not passed this year, it would remain available as an option in the future should California's finances deteriorate. The window to enact a replacement does not close. However, in three years' time, when this MCO package would sunset, the overall arrangement could truly be "too big to fail" at a moment when California's revenues are declining, creating immense pressure to re-enact a similar policy.
- ***Fool Me Once, Shame on You…*** The Governor's proposal would once again alter the purpose of the MCO funding package, which Republicans initially supported in 2009 as a means to maintain the Healthy Families Program. Despite Republican support for that program, it was eventually eliminated and consolidated into Medi-Cal, which offers lower access to care. The 2016-17 budget already assumes that $236 million in higher MCO revenue would fund the continued restoration of a previous reduction to the IHSS program, which was included in the 2015-16 budget. Republicans did not support that restoration and are concerned that the use of MCO package proceeds will once again be subject to the whims of the Democrat majority.
- ***Other Fiscal Risks.*** The Legislative Analyst's Office has pointed out that (1) the reductions to the Gross Premiums Tax and the Bank and Corporations Tax may also reduce education spending under Proposition 98, and (2) that recent court cases involving the Gross Premiums Tax may affect the value of the tax reductions in this package. These are valid concerns that should be fully understood.

Developmental Services

The Department of Developmental Services (DDS) estimates it will serve over 302,000 developmentally disabled Californians in 2016-17 in community settings and institutional developmental centers (DCs). While the vast majority of these individuals receive community-based services, the Governor's budget projects that DCs will serve 1,011 residents in 2015-16 and 847 residents in 2016-17, a decline of 164 residents (16 percent). In contrast, the number of individuals served in community settings is projected to grow to over 302,000 in 2016-17, an increase of 4.2 percent over the enacted 2015-16 caseload.

Some Steps Forward, but More Needed to Sustain Community Service System. The Governor's budget proposes $5.8 billion total funds ($3.4 billion General Fund) for Community Services in 2015-16, an increase of $457 million total funds (8.6 percent) over the enacted budget. Roughly half of this increase is attributed to enrollment growth, while spending would also rise for the state minimum wage ($62 million) and federal overtime regulations ($54 million).

In 2015 Senate Republicans called for significant reforms and additional funding 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. Republican bills introduced in 2015 toward this goal included SB 638 (Stone), a comprehensive reform proposal, and SB 2x 4 (Nielsen, Stone), a community services funding bill. The Governor's budget proposes the following steps in this direction:

- ***Residential Home Rates.*** $46 million ($26 million General Fund) to revise payment rates for Alternative Residential Model (ARM) homes based on four residents instead of six. This proposal is similar to one component of SB 638 (Stone).
- ***Regional Center Case Managers.*** $17 million ($12 million General Fund) to increase the number of case managers who serve families through regional centers. Improving regional center services was also a component of SB 638.
- ***Federal Waiver Compliance.*** $15 million ($11 million General Fund) to provide targeted rate increases aimed at transitioning services to models that will comply with upcoming federal requirements.

These proposals are welcome steps in the right direction, and they would start to address genuine challenges, but more funding and reforms are needed across the spectrum of providers and regional centers. **Senate Republicans continue to call for California to fully reaffirm its commitment to the original vision of the Lanterman Act and ensure that developmentally disabled people can thrive in a sustainable community environment.** SB 818 (Nielsen, Stone), introduced in January 2016, renews the call to use California's substantial existing revenues to provide rate increases of 10 percent for community services. Providing for the needs of those with developmental disabilities is consistent with Senate Republicans' priority to *keep our promises to those with the greatest needs.*

Developmental Center (DC) Closure Plans Continue as Costs Per Resident Rise. The Governor's budget projects DC expenditures of $526 million ($307 million General Fund) for 2016-17, which exceeds the enacted 2015-16 budget by $12 million ($14 million General Fund). The proposed funding increase combined with the declining population raises the **average cost *per DC resident* from $497,000 (total funds) enacted for 2015-16 to over $621,000 in 2016-17, an increase of 25 percent.**

The Governor's budget also continues the process begun in 2015-16 of closing the three remaining DCs (with the exception of the secured area at Porterville DC). In October 2015 the Administration submitted a plan to close Sonoma DC by the end of 2018 and has since announced its intent to submit a plan by April 1, 2016, for the closure of Fairview DC and Porterville DC. The target date of 2021 to close these two remaining DCs has not been changed. To facilitate the closure process, the budget proposes $79 million General Fund to develop community housing and services for current DC residents. In light of the skyrocketing costs per DC resident noted above, it will be critical to monitor the closure process to ensure that spending is truly focused on residents' needs, and not on simply maintaining outdated infrastructure or unnecessary administration.

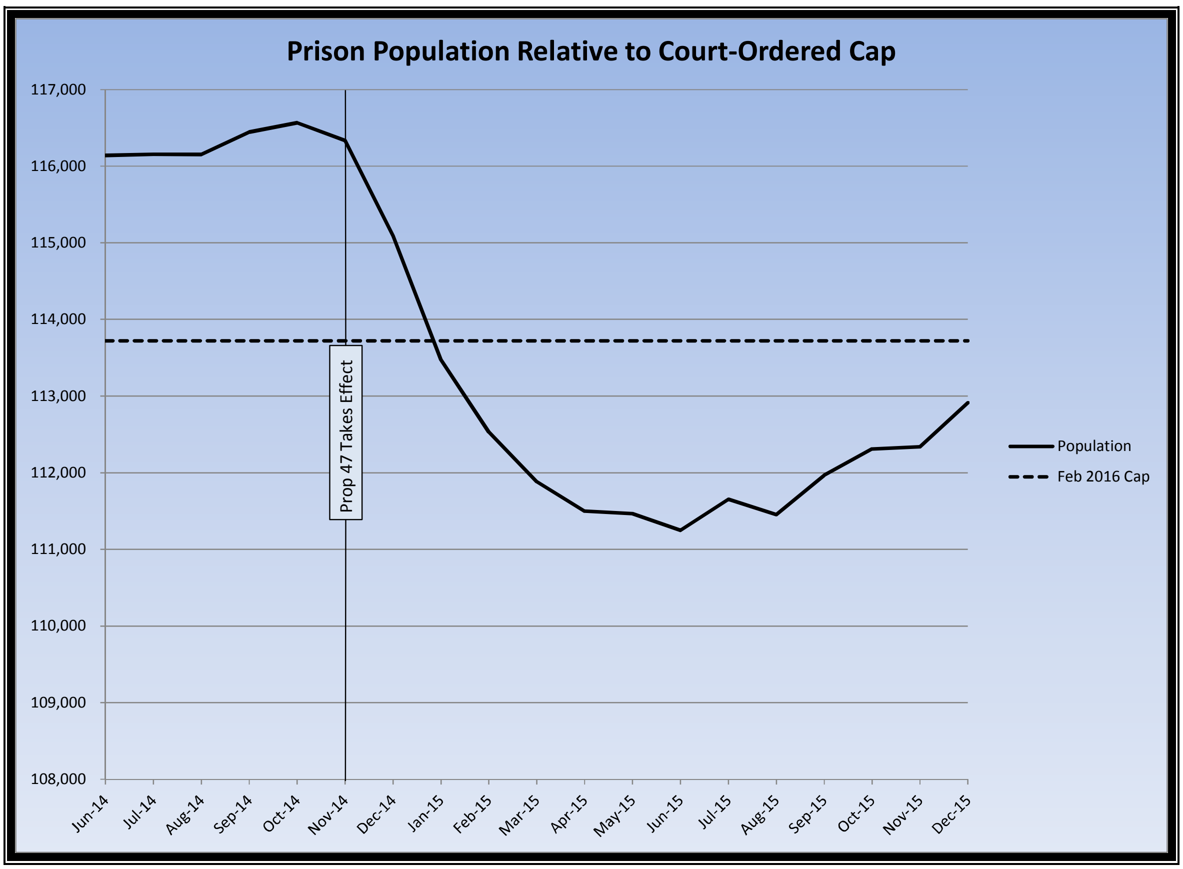
Public Safety

<u>Department of Corrections and Rehabilitation (CDCR)</u>

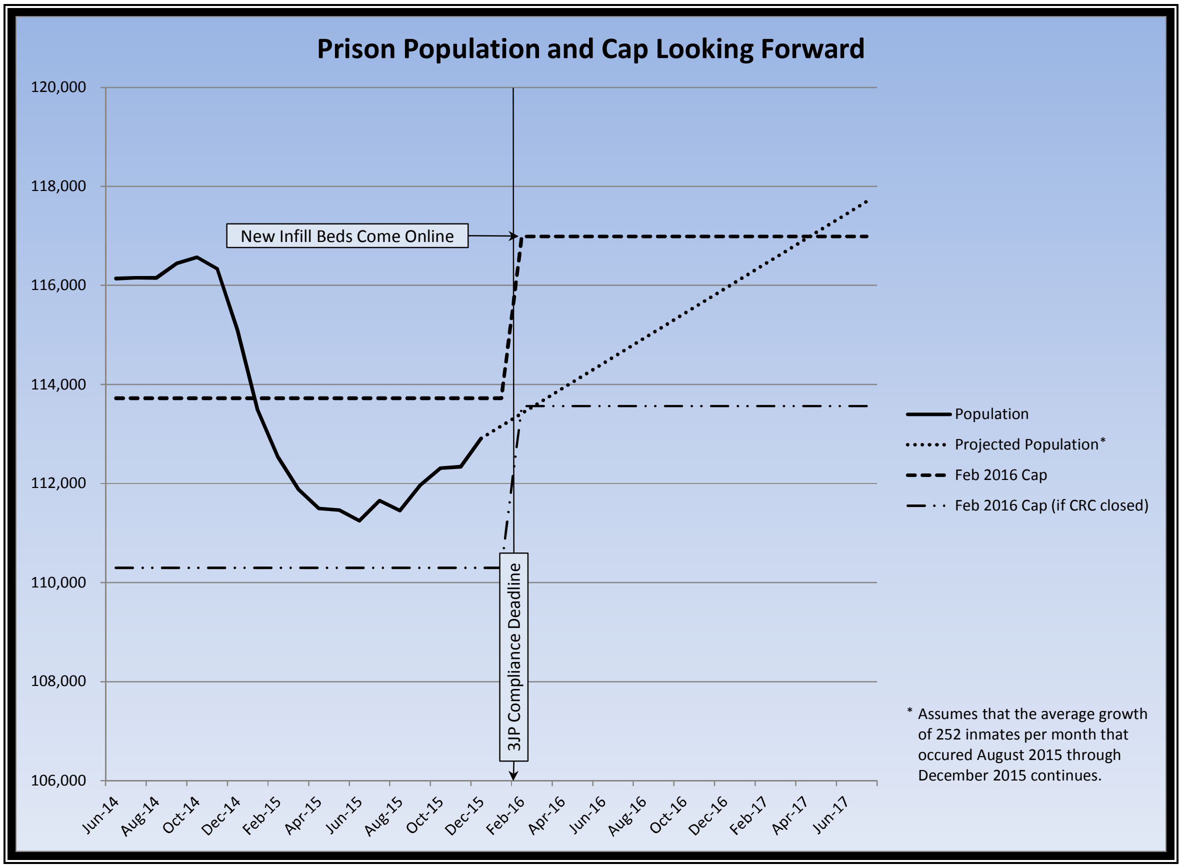
The Governor's budget proposes 2016-17 General Fund spending for CDCR of $10.3 billion, which is approximately $260 million above the Budget Act spending level for 2015-16. The increase in spending is comprised mostly of employee compensation and benefit cost increases ($161 million), increased debt service costs associated with recent prison construction projects ($38 million), and increased health care costs not related to changes in the inmate population ($35 million).

Compliance with Prison Population Cap In Question. The federal three-judge panel (3JP) overseeing the prison overcrowding problem that has plagued California for over a decade ordered CDCR to bring its inmate population below 137.5 percent of design capacity (excluding inmates housed in camps and contract facilities) no later than February 28, 2016. Furthermore, the court expressed in clear terms its intent for the state to maintain compliance with the cap after the February 28 deadline. If the state fails to comply, a court-appointed monitor will order CDCR to immediately release as many felons into our communities as needed to restore compliance, regardless of whether they have been rehabilitated and without concern for the risk they pose of reoffending.

In November 2014, the voters passed Proposition 47, which reduced the penalties for various drug and property crimes. Following enactment of Proposition 47, the inmate population dropped off sharply, falling below the February 2016 cap in January 2015, and bottoming out in July 2015 at 110,973 inmates (134.2 percent of design capacity). However, since that time, it has been increasing steadily by about 250 inmates per month, on average (see chart below). As of January 6, 2016, the prison population was 112,691 (136.3 percent of design capacity).



While the population currently remains below the cap, it is clear that the trend is upward and that the population-reducing effects of Proposition 47 have run their course. The Governor's budget acknowledges this trend and includes a plan to maintain compliance. The plan includes $6 million General Fund for critical repairs and deferred maintenance to keep the California Rehabilitation Center (CRC) in Norco open; maintaining in-state and out-of-state contract beds at current levels; and activation of three new infill facilities (2,376 beds). However, as demonstrated by the chart below, even with these measures, the state could still fall out of compliance as early as the spring of 2017 if the current population trend continues.



Had the Administration closed CRC as legislative Democrats advocated during the development of the 2015-16 budget, the state would almost certainly be out of compliance when the February 2016 deadline arrives (as reflected in the chart above). Senate Republicans have argued since 2013 that closing CRC would jeopardize CDCR's ability to meet the court-ordered cap. While the facility is certainly expensive to operate and has more than its share of maintenance and repair needs, the Governor's plan to continue its operation for the time being is prudent.

Furthermore, reducing the number of contract beds or failing to complete construction of the infill facilities could easily cause the state to fall out of compliance. The Governor's plan appears to represent the minimum effort that could potentially keep the state in compliance through 2016-17. In all likelihood, more resources will be necessary to ensure that the court's compliance monitor does not order the early release of unrehabilitated felons. *Keeping dangerous felons off the streets is an important component of the Senate Republican priority of keeping our communities safe.*

Funding for Rehabilitative and Reentry Programming and Services Could Help. The budget includes increased funding for rehabilitative programming and reentry contracts and services that could help to reduce recidivism, thereby reducing the prison population and helping CDCR to maintain compliance with the 3JP population order. However, the payoff period for these kinds of investments typically spans three to five years and CDCR has at best a shaky track record implementing this type of programming. Thus, additional measures are likely needed to ensure that the state remains in compliance and avoids any early prisoner releases. The Governor's proposals in this area include:

- $57.1 million General Fund to continue and expand community reentry program contracts previously funded from the Recidivism Reduction Fund.
- $15.2 million General Fund to expand in-prison drug treatment programs to the 11 institutions that do not already have them.
- $10 million General Fund to increase programs and services for long-term inmates and lifers with the possibility of parole, including in-custody and parole-based drug treatment, job search training, employment readiness training, job placement, computer literacy, life skills, alcohol and drug counseling certification, and more.

Proposition 47 Savings Fall Short of Expectations

Proposition 47 (2014) reduced the penalties for many drug and property crimes from felonies to misdemeanors and required the resulting state savings to be transferred from the General Fund to the Safe Neighborhoods and Schools Fund (SNSF) and used as follows:

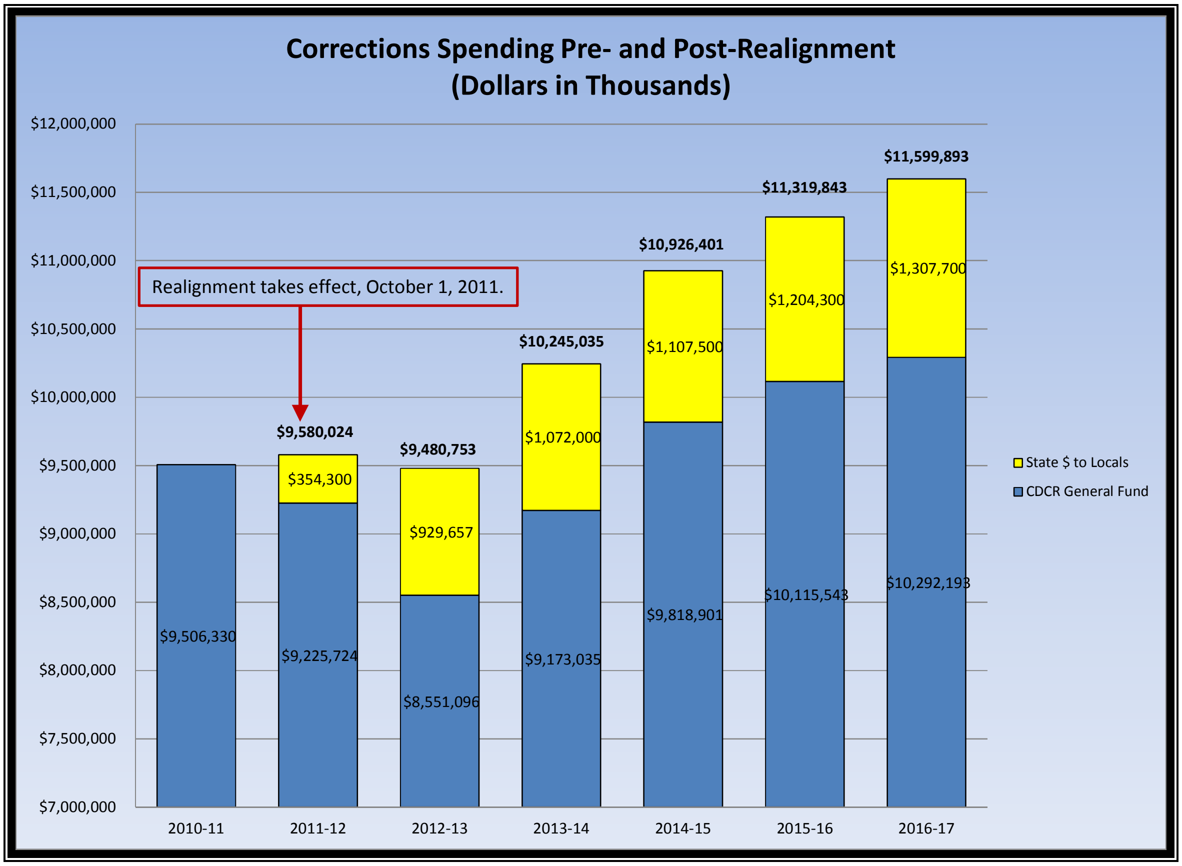
- 65 percent for grant programs administered by the Board of State and Community Corrections (BSCC) to support mental health and drug treatment services designed to reduce recidivism.
- 25 percent for a grant program administered by the State Department of Education aimed at improving outcomes for K-12 public school students by reducing truancy and supporting students who are at risk of dropping out of school or who are victims of crime.
- 10 percent for a grant program administered by the Victim Compensation and Government Claims Board to support trauma recovery centers that provide services to crime victims.

Voters Misled on Savings. The text of the proposition stated that the preliminary estimate of state savings was between $150 million and $200 million per year. The Official Title and Summary also estimated annual savings in the low hundreds of millions of dollars. The Governor's budget includes the first savings estimate allowable under the proposition, but estimates 2015-16 savings of only $29.3 million – well below the $150 million to $200 million savings estimate the proponents used to sell the idea to the voters. Even upon full implementation, the Administration only projects annual savings of $57 million. Clearly, voters were misled by proponents of the proposition, and once again, projected savings from prison reforms are failing to materialize. For 2016-17, Proposition 47 savings yield approximately $19 million for the BSCC grant programs, about $7.3 million for the K-12 grant programs, and roughly $2.9 million for trauma recovery centers. *In order to meet Senate Republicans' priority of keeping our communities safe, it will be critical to monitor criminal justice outcomes associated with Proposition 47, including changes in recidivism rates and program effectiveness.*

Realignment's Continuing Failure to Reduce Costs

The 2011 Public Safety Realignment (Realignment) was heralded by the Governor and legislative Democrats as a way to save billions of dollars annually while reducing the prison population to comply with the 3JP population cap. Not only did it fall well short of meeting the 3JP's population cap, as evidenced by the numerous population reduction measures that have subsequently been implemented, but it has also failed to save the state money. As reflected in the following chart, with the exception of a slight reduction in the first year, CDCR's annual General Fund spending has continued to increase unabated, growing from $9.5 billion in 2010-11 (the last year before Realignment) to a proposed $10.3 billion in 2016-17. During the same period, Realignment funding provided by the state to the counties, which includes automatic increases each year, has grown to $1.3 billion. Total annual state spending on corrections for this population of felons has grown by $2.1 billion since the last year before

Realignment, from $9.5 billion in 2010-11 to a projected $11.6 billion in 2016-17. As such, *Realignment violates the Senate Republican priority of respecting the voters through responsible government*. Notably, no Senate Republicans supported the 2011 Realignment legislation.



Funding for Local Public Safety

In addition to the estimated $1.3 billion the state will provide to counties in 2016-17 for Realignment, the budget includes nearly $1.8 billion in 2016-17 for local law enforcement agencies. Most significantly, this includes $250 million for local jail construction projects, targeted at counties that have received little or none of the $2.2 billion of state funding provided for this purpose since 2007. Eligible counties are summarized below.

No Previous Award					
Alpine	El Dorado	Lassen	Mendocino	Nevada	San Mateo
Contra Costa	Glenn	Marin	Modoc	Plumas	Sierra
Del Norte	Inyo	Mariposa	Mono	San Joaquin	

Partial Previous Award
Placer
Tehama
Ventura

The Governor also proposes $26 million General Fund for city law enforcement to improve outcomes and relationships in the communities they serve. *These two proposals are welcome additions to the* *assistance that local agencies need to meet Senate Republicans' priority of keeping our communities safe*.

Other funding proposals, which continue past programs, are as follows:

- $589.2 million from the Enhancing Law Enforcement Activities Subaccount for Citizens' Option for Public Safety and Juvenile Justice Crime Prevention Act grants, the rural and small county sheriffs program, and other long-standing public safety grants.
- $559.2 million from the Trial Court Security Subaccount for county sheriffs to provide security for the trial courts.
- $161.6 million from the Juvenile Justice Subaccount for the Youthful Offender Block Grant Program and the Juvenile Reentry Grant Program.
- $129.7 million General Fund to continue the Community Corrections Performance Incentive Grant Program (SB 678, 2009).

The budget also includes $36.8 million ($28.1 million General Fund) for local agencies to implement recently enacted legislation, including:

- $26.8 million ($18.1 million General Fund) for juvenile probation departments to improve the continuum of care for foster youth pursuant to Chapter 773, Statutes of 2015 (AB 403).
- $10 million General Fund to reimburse local law enforcement agencies for the costs of reporting data on all stops conducted by sworn personnel, including time, date, location, and reason for the stop, pursuant to Chapter 466, Statutes of 2015 (AB 953).

While this proposed funding would provide fairly comprehensive support for local public safety, notably, the Governor's budget fails yet again to include funding or a requirement to measure the *outcomes* of Realignment. *Senate Republicans believe that responsible government shows respect for the voters when it applies rigorous analysis to ensure that the programs it provides deliver the intended results in a cost-effective manner*. Senator Nielsen previously introduced bills in 2014 (SB 1097) and 2015 (SB 753) to provide funding to counties for a comprehensive data collection program that would allow for thorough analysis of the programs provided to realigned offenders. To date, the elected Democrats who foisted Realignment on the people of California have shown disdain for the voters by obstructing Republican efforts to collect the data necessary to measure the effectiveness of programming provided to realigned offenders.

Transportation

Transportation Infrastructure

The Governor's budget includes a re-introduction of the transportation package the Governor first proposed as part of the 2015 Transportation 1st Extraordinary Session.

Californians Already Burdened with High Fuel Taxes. California has the nation's fifth highest gas taxes (or the highest if the hidden gas tax from Cap and Trade is included) and the highest gas prices in the nation. In fact, California's fuel taxes and other requirements, including a unique summer blend of gasoline, can add over 50 cents per gallon to the price at the pump. These extra costs can easily drive up the gas bill for a two-car family by an additional $700 per year or more.

Governor's Proposal Would Drive Fuel Taxes Still Higher. The Governor continues his 2015 transportation infrastructure plan that would increase gas and diesel taxes and add a new road user fee to raise $3 billion annually. Additionally, the plan would continue to divert approximately $1 billion annually of existing weight fee revenue to pay debt service that was previously a General Fund responsibility and should be again, especially now that General Fund revenues have increased significantly. This $1 billion should be returned to transportation purposes before asking Californians to pay higher taxes and new fees that make driving more costly.

To get California back to basics with great roads and **without raising taxes**, the Senate Republican plan, as proposed in 2015, would provide nearly $3 billion annually and $2.4 billion of one-time funding. Below is a summary of the two plans:

Governor's Tax Plan: $3.6 billion annually, $879 million one-time

- Road User Charge of $65 per vehicle - $2 billion annually
- Increase Gasoline Excise Tax 6 cents and index - $500 million annually
- Increase Diesel Excise Tax 11 cents and index - $500 million annually
- Additional Cap and Trade Proceeds - $500 million
- Caltrans Efficiencies - $100 million
- Expedited One-time Loan Repayments - $879 million

Senate Republican No-Tax Plan: $2.9 billion annually, 2.4 billion one-time

- Dedicate Weight Fees to Transportation - $1 billion annually
- Dedicate Hidden Gas Tax (Cap and Trade) Revenues to Transportation - $1.9 billion annually
- Expedited One-time Loan Repayments - $1.1 billion
- Repayment of Weight Fees Loaned to the General Fund - $1.3 billion

Governor's Plan Lacks Sufficient Reforms to Ensure Efficient Use of Funds. While the Governor's proposal includes some reforms requiring performance targets, increased reporting, streamlined project delivery, and extension of public-private partnerships, it does not go far enough. The Governor's plan would allow for contract staff to double over the next five years on projects funded by new revenue. However, according to a 2014 Legislative Analyst Office (LAO) report, Caltrans was overstaffed by approximately 3,500 positions at a cost of $500 million annually. Even considering modest reductions since the report was published, the LAO maintains that overstaffing continues. The overstaffing was created in part by an arbitrary 90/10 ratio of state staff to contract staff that the Legislature imposes annually in budget provisional language. The Governor's plan allows for increased contract staff but does not limit the addition of state staff, potentially resulting in an unchanged ratio, continuing a rigid staffing structure unable to adjust as workload changes.

In contrast, the Senate Republican plan includes broader reforms to ensure transportation dollars are spent as efficiently as possible. Reforms include a requirement to increase the ratio of contract staff to state staff, the creation of a Transportation Inspector General, increased local control, and an independent California Transportation Commission.

Governor's Plan Inconsistent with Other State Policies. The Governor's plan assumes gasoline and diesel consumption would remain constant despite the Governor's Executive Order B-30-15 to the Air Resources Board (ARB) to reduce petroleum consumption by 50 percent by 2030. If the ARB actually reduced consumption by that amount, the Governor's plan would fall short of revenue projections by hundreds of millions of dollars.

High-Speed Rail

The Governor's budget includes $1.8 billion to continue to build the high-speed rail system. Specifically, $1.1 billion is for the local/regional components of the system, $611 million is for capital outlay, and the remaining $42 million is for administration and contracts. Notably, the current year expenditures reflect a significant decrease from $3.1 billion at budget enactment last year to $897 million presently. This decrease reflects a shift of $1.1 billion for the local/regional components from the current year to the budget year and a decrease of $1 billion for Phase I construction. This appears to be an accounting gimmick that shifts costs to the future and reduces transparency, rather than an actual reduction. It remains likely the project will exceed the current cost estimate of $68 billion.

Department of Motor Vehicles

Lack of Fiscal Prudence Results in Increased Vehicle Registration Fees. The Governor's budget includes a proposal to increase vehicle registration fees by $10 per vehicle, generating $529 million annually. Per the Administration, this will correct a structural imbalance of $500 million annually in the Motor Vehicle Account (MVA), which funds the Department of Motor Vehicles (DMV) and the California Highway Patrol (CHP). The Administration provides no detail on the cause of the deficit. However, as noted in our 2014-15 budget documents, the cost to issue licenses to undocumented residents (AB 60, Chapter 524, Statutes of 2013) was not fully funded by the amount of fees to be collected. AB 60 specifically provides authority allowing for an additional fee to be charged to applicants until June 30, 2017 to offset reasonable administrative costs. The Administration opted not to charge an additional fee, resulting in approximately $95 million of costs being absorbed by the MVA.

Furthermore, each year between $70 million and $80 million is transferred from the MVA to the General Fund. This revenue is primarily generated by the sale of information, such as driver or vehicle records purchased by businesses, insurance companies, toll authorities and the general public, and is the only MVA revenue that is not constitutionally protected, allowing for a General Fund rip-off.

These two instances of fiscal mismanagement raise some concerns. First, what other mismanagement is occurring in these programs? And second, how will these new revenues be mismanaged? *Raising these concerns is consistent with the Senate Republican priority of respecting voters through responsible government*. With greater fiscal responsibility, fee increases could be mitigated or avoided completely.

New Motor Voter Program. The Governor's budget includes $3.9 million General Fund to create an automatic voter registration process that is integrated with DMV's driver license application and renewal process. The New Motor Voter Program was authorized by Chapter 729, Statutes of 2015 (AB 1461) and establishes a process to automatically register to vote every "eligible" individual that applies for a driver's license, identification card, or change of address unless the individual declines to be registered. This proposal is premature because the Statewide Voter Registration Database has not been completed, and the Secretary of State's Office has not requested resources to implement its responsibilities under AB 1461.

Resources, Environmental Protection, and Energy

Within the Resources, Environmental Protection, and Energy areas, the Administration expands the types of programs and projects to be funded from Cap and Trade revenues, provides additional funding for drought and firefighting emergency response activities, funds California Water Action Plan activities, and makes other noteworthy program proposals.

More Cap and Trade Spending and New Greenhouse Gas Emission Reduction Targets. Pursuant to the Governor's Executive Order issued in April of 2015 (B-30-15), the $3.1 billion Cap and Trade expenditure plan proposed in the 2016-17 budget is meant to achieve a greenhouse gas (GHG) reduction target for the state of 40 percent below 1990 levels by 2030. It should be noted that legislation directed at achieving these same goals, SB 32 (Pavley) of 2015, failed to pass the Assembly. Furthermore, SB 350 (De Leon) of 2015 at one point included a requirement to reduce petroleum use by 50 percent, but this requirement was struck from the bill before it became law. Therefore, there is no statutory authority to reduce GHG beyond the current goals of 1990 levels by 2020, pursuant to AB 32 of 2006. Never the less, the Governor is proposing to include programs that would reduce petroleum use by 50 percent and reduce short-lived climate pollutants by 40 percent to 50 percent.

Currently, 60 percent of Cap and Trade revenues are 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 various programs, such as low-carbon transportation, natural resources programs, and energy programs. Last year, about $1 billion of this funding was not appropriated and instead is now proposed as part of the $3.1 billion expenditure plan for 2016-17. This $1 billion will be appropriated within the 40 percent program allocation in 2016-17.

The *chart on the following page* identifies the programs proposed to be funded in 2016-17.

Figure EPA-01

2016-17 Cap and Trade Expenditure Plan

(Dollars in Millions)

Investment Category	*Department*	*Program*	*Amount*
Exisiting Programs			
Continuous Appropriation	High-Speed Rail Authority	High-Speed Rail Project	$500
	State Transit Assistance	Low Carbon Transit Operations	$100
	Transportation Agency	Transit and Intercity Rail Capital Program	$200
	Strategic Grow th Council	Affordable Housing and Sustainable Communities Program	$400
Annually Appropriated Programs			
50 Percent Reduction in Petroleum Use	Transportation Agency	Transit and Intercity Rail Capital Program	$400
	Caltrans	Low Carbon Road Program	$100
	Air Resources Board	Low Carbon Transportation & Fuels	$500
	Energy Commission	Biofuel Facility Investments	$25
Local Climate Action	Strategic Grow th Council	Transformational Climate Communities	$100
Short-Lived Climate Pollutants	Air Resources Board	Black Carbon Woodsmoke	$40
		Refrigerants	$20
	Cal Recycle	Waste Diversion	$100
	Department of Food and Agriculture	Climate Smart Agriculture - Healthy Soils and Dairy Digesters	$55
Safeguarding California/ Water Action Plan	Departments of Food and Agriculture & Water Resources	Water and Energy Efficiency	$30
	Energy Commission	Drought Executive Order - Water and Energy Technology Program & Applicance Rebates	$60
	Department of Fish and Wildlife	Wetlands and Watershed Restoration/CalEcoRestore	$60
Safeguarding California/ Carbon Sequestration	CAL FIRE	Healthy Forests	$150
		Urban Forestry	$30
	Natural Resources Agency	Urban Greening	$20
Energy Efficiency/ Renew able Energy	Department of General Services	Energy Efficiency for Public Buildings	$30
	I Bank	California Lending for Energy and Environmental Needs Center	$20
	Conservation Corps	Energy Corps	$15
	Department of Community Services and Development	Energy Efficiency Upgrades/ Weatherization	$75
	University of California/ California State University	Renew able Energy and Energy Efficiency Projects	$60
Total			**$3,090**

Source: Department of Finance

The California Air Resources Board (ARB) still has no sound metrics in place to evaluate GHG reductions, which make the confirmation of GHG reductions difficult to measure. Even if a program were not to achieve any GHG reductions, though, it is not clear whether the Administration would hold anyone accountable for the misuse of these funds. The Governor continues to use Cap and Trade tax revenues to fund the High-Speed Rail (HSR) project, which does <u>not</u> meet the requirements of reducing

GHG emissions since the project would actually increase GHG significantly during construction. These budget proposals continue to have no clear nexus to GHG reductions, which supports the argument that the **Cap and Trade fee is actually an illegal tax.** The California Chamber of Commerce has sued the state over this program on the grounds that the fee is actually a tax, even though it was approved with only a majority vote. The litigation is currently at the 3rd District Court of Appeals, which is expected to rule sometime in 2016.

To date, the ARB has held 13 auctions which have generated $3.5 billion in state revenues. In addition, $2.7 billion has also been generated for investor-owned utilities and publicly owned utilities, with the revenues to be used as directed by the California Public Utilities Commission or governing boards for ratepayer benefits pursuant to AB 32. To fund the 2016-17 budget proposal of $3.1 billion and maintain a $500 million reserve, an additional $2.8 billion will need to be produced from future Cap and Trade auctions, which will likely occur given that transportation fuels were added under the Cap and Trade program in January of 2015.

As a result of Cap and Trade and related policies, California has the most expensive gasoline in the country and residential energy rates that are among the highest in the nation. Although Senate Republicans do not support this Cap and Trade tax, since the tax continues to be imposed, the revenues should be used to help---not hurt---California families.

Senate Republicans proposed a package of legislation as part of the 2015 1st Extraordinary Session for Transportation that would better spend these new Cap and Trade revenues and provide a greater benefit to all Californians while helping to create jobs and improve our transportation infrastructure (*See Transportation Section, page 32*).

Emergency Drought Response Funding. One-time funding of $323 million ($212 million General Fund) is proposed in 2016-17 for drought response activities within various departments for the protection of water supplies, water conservation, and emergency response. This funding is summarized in the chart below. Only about $47 million of these funds would provide direct water and food assistance to individuals, while the rest of the funds provide enhanced fire protection, the administration of water curtailment activities, water conservation and drinking water projects, rebates for appliances, and fish and wildlife protection projects. *Senate Republicans support drought assistance but want to ensure that the majority of these funds are directed towards immediate assistance for Californians most in need of critical water supply and not for projects or programs meant to achieve other unrelated Democrat water policy goals.*

Figure RES-01 **Emergency Drought Response** (Dollars in Millions)			
Investment Category	*Department*	*Program*	*Amount*
Protecting Water Supplies	Department of Water Resources	Emergency Salinity Barriers in the Delta	$42.0
	Department of Water Resources	Local Assistance for Small Communities	$5.0
	Water Board	Water Curtailment	$5.4
	Water Board	Emergency Drinking Water Projects	$16.0
Water Conservation	Department of Water Resources	Urban Water Conservation & Save Our Water Campaign	$15.0
	Energy Commission	Rebates for Appliances	$30.0
	Energy Commission	Water and Energy Technology Program	$30.0
	Department of Food and Agriculture	Agricultural Water Conservation	$20.0
Emergency Response	Department of Forestry and Fire Protection	Enhanced Fire Protection	$77.4
	Department of Water Resources	Drought Management and Response	$12.0
	Department of Fish and Wildlife	Protection of Fish and Wildlife	$17.7
	Department of Social Services	Drought Food Assistance	$18.4
	Office of Emergency Services	California Disaster Assistance Act	$22.7
	Office of Emergency Services	State Operations Center	$4.0
	Department of Community Services and Development	Farmworker Assistance	$7.5
Total			**$323.1**

Resource: Department of Finance

Emergency Fire Response Funding. The Administration is providing additional General Funding of $506 million, including $406 million in the current year and $100 million in the budget year, for emergency fire response activities. Specific proposals include social services related to housing needs, emergency funding for firefighting activities, debris removal associated with the Butte and Lake fires, and the backfill of Lake and Calaveras County property, sales, and use tax losses. The Administration also plans to provide relief to these same counties by paying local costs for existing CalFire contracts from CalFire's current year General Fund budget. *Senate Republicans will work to determine if this amount of funding adequately supports the ongoing needs of these counties devastated by recent wildfires.*

California Water Action Plan Expenditures. The budget proposes to spend $635 million to implement the Water Action Plan that the Governor released in January 2014. This funding consists of $465 million from the Water Quality, Supply, and Infrastructure Improvement Act of 2014 (Proposition 1), $110 million General Fund, and $60 million from Cap and Trade revenues (also contained with the Cap and Trade program described above). These funds will be used for the following:

- Klamath River Agreements ($250 million), Central Valley Improvement Act ($90 million), and San Joaquin River Settlement Agreements ($45 million) (Prop 1)
- Flood Protection in the Central Valley ($100 million, General Fund)
- Salton Sea Restoration ($80 million, Prop 1)
- Wetland Restoration ($60 million, Cap and Trade Revenues)

- Update of the Delta Plan ($3.6 million, General Fund)
- Manage and Prepare for Dry Periods ($3 million, General Fund)
- Groundwater Management ($2.5 million, General Fund)
- Investment Strategy ($1.2 million, General Fund)

The $100 million General Fund for Central Valley Flood Protection projects is a good step toward providing improvements to our critical water infrastructure, which Senate Republicans are committed to building and restoring. At this time, no surface storage monies (out of the $2.7 billion continuous appropriation in Prop 1) have been allocated for water storage projects. Under the terms of Proposition 1, the California Water Commission has the authority to distribute funding for water storage projects, but not until December 15, 2016, when regulations are required to be completed. *Senate Republicans believe this funding is vital to the development of new surface water storage to increase water supplies to Californians and will continue to focus on getting this funding allocated as soon as possible.*

Stealing Off-Highway Vehicle (OHV) Funds to Backfill State Park's Deficits. The budget repeats an unfortunate recent pattern in which the Administration punishes a State Parks program that is self-sufficient but rewards programs that continue to fail. Specifically, the Administration is proposing to transfer $31 million in fuel tax revenues meant for the OHV program to the State Parks and Recreation Fund to be dispersed statewide among non-OHV parks and programs to support its base operating budget. These operations were supposed to be more self-sufficient at this time as the Legislature had required the department to develop revenue generating projects and partnerships for the operation and maintenance of its park units. This will be the third consecutive year of providing additional funding to keep the department solvent. The only good news for the OHV program is that the Administration is finally repaying $112 million in General Fund loans made from the Off-Highway Vehicle Trust Fund in 2008 and 2009. Unlike these loans, the $31 million in fuel tax revenues will never be repaid.

New California Endangered Species Act Fee to Offset the Environmental License Plate Fund (ELPF) Spending Deficit. The Governor's budget proposes that the Department of Fish and Wildlife assess a new fee on incidental take permits (ITP) in order to fund workload currently funded by the ELPF. This new fee would generate $1.5 million in 2016-17 and $2.5 million on going. Although exact fee costs are unknown at this time, the department estimates a cost of $25,000 per ITP, but these costs could be higher or lower depending of the size of the project. In recent years, the ELPF has had a structural imbalance while new projects and programs continued to be added. An example of such projects is the Climate Assessment Study and Climate Ready Grant program. The Governor's proposal will also raise the personalized license plate fee by $5 dollars to generate $1.5 million in 2016-17 and $2.5 million ongoing and provide General Fund and special fund increases.

The California Environmental Protection Program receives revenue from the sale of personalized motor vehicle license plates by the Department of Motor Vehicles. These funds must be used for specific environmental programs as specified in statute. To the extent that this program is dependent on individuals purchasing personalized license plates, the program should be expanded or restricted based upon the willingness of individuals to purchase these plates. In recent years, the State Auditor has criticized the use of the funds (see *Special Interest License Plate Funds Report of 2013)*, indicating that the monies were used in ways inconsistent with established state law and that the Natural Resources Agency and some of its departments could not demonstrate the appropriateness of the expenditures charged to the fund. The Natural Resources Agency will spend $4.3 million in 2016-17 just for administrative costs alone. A further evaluation of administrative costs and program spending should be undertaken before raising new fees on existing programs.

Increasing Costs to California Families to Fund Free Cell Phones with Unlimited Voice, Texting, and Data Plans. The Governor's 2016-17 Budget proposes to increase telephone fees yet again on hardworking families by $282 million to fund the increased subscribership for wireless service plans by California Lifeline participants. In 2016-17, the program is projecting 3.7 million wireless subscribers. The individuals who qualify for free cell phone service are adults and emancipated minors with income at or less than 200 percent of the federal poverty level (about $23,500 annually for an individual). This additional funding allows eligible households to subscribe to discounted wireless service plans that include voice, text, and internet access. This program also had deficits of $96 million in 2014-15 and $143 million in 2015-16 due to increased subscribership numbers.

The Lifeline program was meant to provide essential phone service, not texting and internet access. Families who pay for their own cell phone plans are really funding two plans: their own and one for Lifeline participants. These families may not be able to afford their own texting plans, yet they are required to fund it for someone else. Pursuant to Prop 26, these ratepayer fees are really a tax because the ratepayer is receiving no direct benefit.

Employee Compensation

Employee Compensation and Health Care Costs Increase. The proposed 2016-17 budget includes an additional $220 million ($26.7 million General Fund) for employee pay raises and increases in health and dental benefits, bringing the **total cost of state employee salaries and benefits to about $25 billion**. The state already spends more per employee than all but three other states. Since 2006-07, base employee compensation costs have increased $3.8 billion ($1.7 billion General Fund), and cumulatively, employee compensation increases have resulted in an additional $25.2 billion ($12.4 billion General Fund) of state expenditures at the same time taxes and fees have been increased by tens of billions.

A Policy First: Setting Aside Funding for Negotiations with Bargaining Units. The Administration is actively negotiating with four bargaining units (BUs), representing correctional peace officers, firefighters, scientists, and craft and maintenance workers. With the exception of firefighters, each of the BUs' memorandums of understanding (MOUs) expired in July 2015. For firefighters, the current MOU expires July 1, 2017, but the BU has exercised its option to reopen the contract. Additionally, 15 BUs with contracts that expire in July 2016 have begun collective bargaining negotiations with the Administration. In the past, the Governor's January budget typically did not include funding for contracts under negotiation even though it was inevitable that those negotiations would create new costs. For the first time, Governor Brown's proposed 2016-17 budget sets aside an additional $350 million ($300 million General Fund) to fund potential employee compensation increases that may result from the current negotiations. Setting aside funding could be seen by BUs as a "funding floor" while negotiating the contract, but building some level of additional expenditures into the budget at the outset will help limit the ability of legislative Democrats to spend the money on other programs. Planning ahead for expenditures that are likely to materialize is prudent, and *this proposal is consistent with Senate Republicans' priority of respecting the voters through responsible government.*

Addressing Retiree Health Obligations. As part of the current and upcoming bargaining negotiations, the Administration intends to seek additional contributions from state employees to begin prefunding retiree health care, consistent with the agreement reached last year with BU 9 (professional engineers). *This is consistent with Senate Republicans' fiscal priority of paying down the state's obligations.* (See *Statewide Debts and Liabilities* on page 43 for discussion.) It will be important for the state to minimize the cost of contract concessions that BUs might seek as offsets to the prefunded benefits. 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.

Local Government

Redevelopment Agencies (RDAs)

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

Dollars in millions	Total to be Allocated	Schools	Cities	Counties	Special Districts
2011-12 & 2012-13	$4,057.30	$2,252.60	$619.80	$875.10	$309.90
2013-14	$2,144.20	$1,229.10	$377.80	$425.80	$111.50
2014-15	$2,091.30	$1,224.10	$361.50	$395.80	$109.90
2015-16	$1,917.30	$1,123.90	$328.91	$356.90	$107.50
2016-17	$1,791.70	$1,054.40	$314.30	$327.50	$95.50

Source: Department of Finance

On an ongoing basis, Proposition 98 General Fund savings are estimated to exceed $1 billion annually, and it is estimated that additional ongoing property tax revenues of more than $770 million annually will be distributed to cities, counties, and special districts. At this time, we do not anticipate that the administration will propose any additional legislative changes to the statutes governing RDA dissolution.

State-Mandated Local Programs

Pre-2004 Mandate Reimbursements. On May 27, 2015 the Department of Finance notified the legislature that the "trigger" mechanism included in the 2014 Budget Act would be "pulled" and all outstanding Pre-2004 mandates costs would be paid. In November 2015, the Controller reported that $778.2 million would be paid to local governments to reimburse unpaid mandate reimbursement claims that had accumulated prior to the passage of Proposition 1A of 2004.

Election-Related Mandates. Last year Senate Republicans fought to include $77 million General Fund to reimburse counties for accumulated costs for nine election-related mandates and to reactivate those election-related mandates for 2015-16. Funding for these mandates continues to be an important issue because, as stated by the Legislative Analyst's Office, "Suspending elections mandates poses a significant risk to state elections. We believe that the administration's proposal to suspend the mandates represents the worst option as it carries with it the largest risk for inconsistencies in California elections."

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

Other Local Initiatives

The 2016-17 Governor's Budget includes $29.8 million General Fund to provide assistance to local governments in the following areas:

- Siting Incentive Grants – $25 million to provide incentives to cities and/or counties that approve, between January 1, 2016 and June 30, 2017, new long-term permits for hard-to-site offender rehabilitation facilities that improve public safety and support the criminal justice system by providing service such as substance use disorder treatment, mental health, and reentry programs. This proposal appears to help overcome "not-in-my-backyard" obstacles to implementing public safety realignment, and *is consistent with the Senate Republican priority to ensure that local governments have the tools and resources necessary to protect our communities.*
- Wildfire Relief – In 2015, Lake and Calaveras counties battled two devastating wildfires that burned more than 145,000 acres and destroyed more than 2,000 homes and other structures. The budget includes $4.8 million to help these counties recover, including:
    - $1.9 million to backfill lost property tax, sales and use tax, and transient occupancy tax revenues in 2016-17. While this backfill is labeled as "one-time" in nature, the Department of Finance indicates that it will re-evaluate additional needs facing cities, counties and special districts in future years.
    - South Lake County Fire District and Calaveras County will be relieved of their existing fire protection contracts with CalFIRE (totaling nearly $2.9 million in 2016-17). In the interim, CalFIRE will absorb these costs within its existing General Fund budget.

Statewide Debts & Liabilities

Debt Payments in Governor's Budget. The budget includes nearly $8.4 billion to pay a portion of the state's debts and liabilities (currently estimated to exceed $322 billion, and expected to grow), including the following components:

- About $5.4 billion to pay debt service costs for the state's outstanding and planned General Obligation (GO) and Lease Revenue (LR) bonds in 2016-17, as required by the California Constitution and respective debt issuance documents.
- Nearly $1.6 billion to pay a variety of debts and liabilities as mandated by Proposition 2, which was passed by the voters in November 2014.
- Nearly $1.4 billion to pay down a portion of the state's mandate obligations to K-12 schools and community colleges.

Proposition 2 Liabilities. The Governor's budget identifies $223.7 billion of debts and liabilities facing the state in the coming years, including outstanding budgetary borrowing and state retirement liabilities. The following table represents only those liabilities that are identified and mandated for repayment from General Fund revenues pursuant to Proposition 2 (see *Proposition 2* on page 11 for details).

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

	At Start of 2016-17	Proposed Use of Proposition 2 Funds				Remaining Liabilities Following 2019-20
		2016-17	2017-18	2018-19	2019-20	
Budgetary Borrowing						
Loan from Special Funds	**$1,806**	$955	$559	$292	$0	$0
Underfunding of Proposition 98 - Settle-Up	**1,232**	257	286	337	352	$0
Pre-Proposition 42 Transportation Loans	**879**	173	220	220	266	$0
State retirement Liabilities					0	
State Retiree Health	**71,773**	0	50	150	250	N/A
State Employee Pensions	**43,291**	0	0	0	0	N/A
Teachers' Pensions (State Portion = $14.916 billion)	**72,718**	0	0	0	0	N/A
Judges' Pensions	**3,358**	0	0	0	0	N/A
Deferred payments to CalPERS	**570**	0	0	0	0	N/A
University of California Retirement Liabilities						
University of California Employee Pensions	**10,786**	171	169	0	0	$10,446
University of California Retiree Health	**17,270**	0	0	0	0	N/A
Unallocated					123	-$123
Totals	**$223,683**	**$1,556**	**$1,284**	**$999**	**$991**	

Other Debts and Liabilities. Proposition 2 of 2014 identified specific categories of debt that must be retired using amounts calculated pursuant to that initiative. Debts and liabilities identified by Proposition 2, however, do not represent the universe of debt facing the state. Significant debts that are not identified in Proposition 2 include:

- <u>Long-Term Infrastructure Debt</u> – As discussed above, there is little fanfare for the $76 billion of GO debt and $11.4 billion of LR debt that the state already owes to investors. The budget assumes payments of about $5.4 billion for both GO and LR debts in 2016-17. Additionally, the state has the authority to issue approximately $28.6 billion of GO debt to investors that has been "authorized, but not issued" to date. The budget projects that approximately $4.0 billion of additional GO debt will be issued during 2016. While it is likely that the state will not issue all of this debt at once, over time the issuance of this debt will drive up annual debt service costs.

- Unemployment Insurance (UI) Debt – In order to pay all eligible unemployment insurance claims during the "Great Recession," the UI fund began incurring debt (a loan from the federal government) in January 2009. In October 2015 the Employment Development Department reported that, "The UI Fund deficit was $8.6 billion at the end of 2014. **The deficit is projected to decrease to $6.7 billion by the end of 2015,** $4.5 billion by the end of 2016, and $2.0 billion by the end of 2016 if changes are not made to the financing structure."
- Local Government Mandate Debts – Proposition 1A of 2004 requires the state to either fully fund or suspend state-mandated local programs (mandates). In order to avoid paying for the ongoing cost of various mandates, the state continues to suspend and defer 59 mandates. An additional 12 mandates have expired and are no longer active. However, when a mandate is suspended, deferred, or expired, there is no timeline for reimbursing local governments for prior costs incurred. As such, the state currently owes more than $1.0 billion to local governments for mandates that have been suspended or deferred (some for more than a decade), or that have expired.
- Education Mandate Debt – The state also owes $3.2 billion to K-12 schools and community colleges for mandate costs. The Governor's budget proposes to allocate $1.4 billion of Proposition 98 General Fund to reduce the backlog of unpaid K-14 education mandate claims, which will leave about $1.8 billion of mandate debts to be paid after 2016-17.

Adding "Other Debts and Liabilities" to those identified in Proposition 2 brings total statewide debts and liabilities up to about $322.6 billion. The following table reflects the totality of these obligations, as well as payments estimated by the Administration over the next four years.

Total Statewide Debts and Liabilities
(Dollars in Millions)

	At Start of 2016-17	Proposed Debt Payments 2016-17	2017-18	2018-19	2019-20
Debts & Liabilities Identified in Proposition 2	**$223,683**	$1,556	$1,284	$999	$991
Long-Term Infrastructure Debts (GO & LR Bonds)	**$89,139**	$5,507	$5,498	$5,724	$5,697
Unemployment Insurance Debt	**$5,500**	$0	$0	$0	$0
Suspended Mandate Debt	**$1,038**	$0	$0	$0	$0
Education Mandate Debts	**$3,197**	$1,357	$0	$0	$0
Totals	**$322,557**	**$8,420**	**$6,782**	**$6,723**	**$6,688**

Senate Republicans are committed to holding government accountable to the people by paying down state debts. Though this budget does meet constitutional requirements for debt payments, it only pays off a small portion of the state's debts and liabilities. With its current windfall revenues, the state should do more than make the minimum payments on its "credit cards." While California's credit rating has improved in the past year (according to Standard & Poor's), 47 other states have higher credit ratings. *The state could pay down additional debts and avoid future costs to help improve the state's credit rating.*

Statewide Issues and Various Departments

Statewide Infrastructure

The budget proposes to spend $2.3 billion on one-time infrastructure projects, including:

- $1.5 billion General Fund to establish pay-as-you-go renovation or replacement projects on state office buildings in Sacramento. Projects would include replacing the Natural Resources building and the vacant Department of Food and Agriculture Annex, as well as renovating the State Capitol Annex and other buildings (identified as the Bonderson building, the Bateson building, the Unruh building, and the Personnel building). Pay-as-you-go is a commendable approach to infrastructure projects; however, this proposal ignores essential infrastructure projects statewide. *Senate Republicans are prioritizing getting "back to basics" by building and restoring roads and water systems so that all Californians can once again rely on these community essentials.* Rather than focus $1.5 billion on projects that would only benefit state employees in Sacramento, it would be preferable to focus on helping Californians more broadly, such as by making headway on the billions of dollars in unmet transportation infrastructure needs.
- $518 million ($500 million General Fund and $18 million Motor Vehicle Account), to be allocated to a wide range of state departments to address the state's growing deferred maintenance costs. A complete list of departmental allocations can be found on page 130 of the 2016-17 Governor's Budget Summary. Significant proposals include $289 million for Community Colleges and $100 million for levee repairs.
- $289 million Proposition 98 General Fund for California Community Colleges to address deferred maintenance needs in the community college system, which is discussed further in the *Higher Education* section on page 17**.**

Employment Development Department (EDD)

The budget includes $13.8 billion ($147.3 million General Fund) in support of EDD programs in 2016-17, including the following notable items:

- Approximately $12.6 billion special funds to pay unemployment and disability benefits to workers who have been injured on the job or lost their job through no fault of their own. This budget also decreases funding necessary to administer the unemployment insurance program due to fewer claims being made on the system.
- $123.8 million General Fund to pay interest costs to the federal government on loans taken out during the Great Recession to pay for unemployment benefits. EDD estimates that outstanding debt to the federal government will decrease to about $6.7 billion by the end of 2016, resulting from increased UI taxes on employers imposed by the federal government. One option not included in this budget would be for the General Fund to pay down this debt and expedite the date in which UI taxes on employers would decrease (when the debt is fully paid off). This option, however, could result in calls from various labor groups to increase state UI taxes to support the UI program in the long run.

Department of Technology

The budget includes $364.5 million (only $4.5 million General Fund) in support of the department's operations in 2016-17, including the following notable item:

- Approximately $1.7 million special funds to provide independent project oversight for reportable IT projects, and extended procurement support intended to "improve the quality, value, and likelihood that reportable IT projects…will be successful." This proposal may require additional scrutiny, especially since the department recommended canceling two additional systems integrator contracts on reportable IT projects this past fall (CalTrans' $23.6 million *Construction Management System* and the Secretary of State's $26.9 million *California Business Connect* Project).

State Controller's Office

The budget includes $200.5 million ($48.9 million General Fund) to support the Controller's programs in 2016-17, including the following notable item:

- Approximately $4.8 million special funds to continue pursuing litigation against the most recent vendor responsible for the state's proposed new human resources management system (SAP). By the end of 2016-17, the Controller's Office will spend more than $43.3 million on litigating this case after spending more than $260 million (of $363 million) on the failed project, and it is likely that the Controller will need to restart the project from scratch to complete a new system.

Office of Planning and Research (OPR)

The budget includes $546.3 million (only $14 million General Fund) in support of OPR's operations in 2016-17, including the following notable items:

- $100 million Greenhouse Gas Reduction Fund (GGR Fund) for the Transformational Climate Communities Program, which would "support local climate action implementation in the state's top five percent disadvantaged communities." This would be in additional to the existing $400 million GGRF under OPR's purview for the Affordable Housing and Sustainable Communities Program. Additional details regarding the state's Cap and Trade expenditure plan and Senate Republican concerns regarding its implementation can be found in the *Resources, Environmental Protection, and Energy* section that begins on page 34**.**
- $10 million General Fund to be spent over the next 24-month period to further the efforts of the California Initiative to Advance Precision Medicine. This builds on the $3 million appropriation included in the 2014 Budget Act, and last year's trailer bill to exempt certain contracts with specific researchers from the state's competitive bidding rules (to expedite the use of funds).

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