Highlights and Analysis of the Governor's May Revision

SENATE REPUBLICAN
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Executive Summary

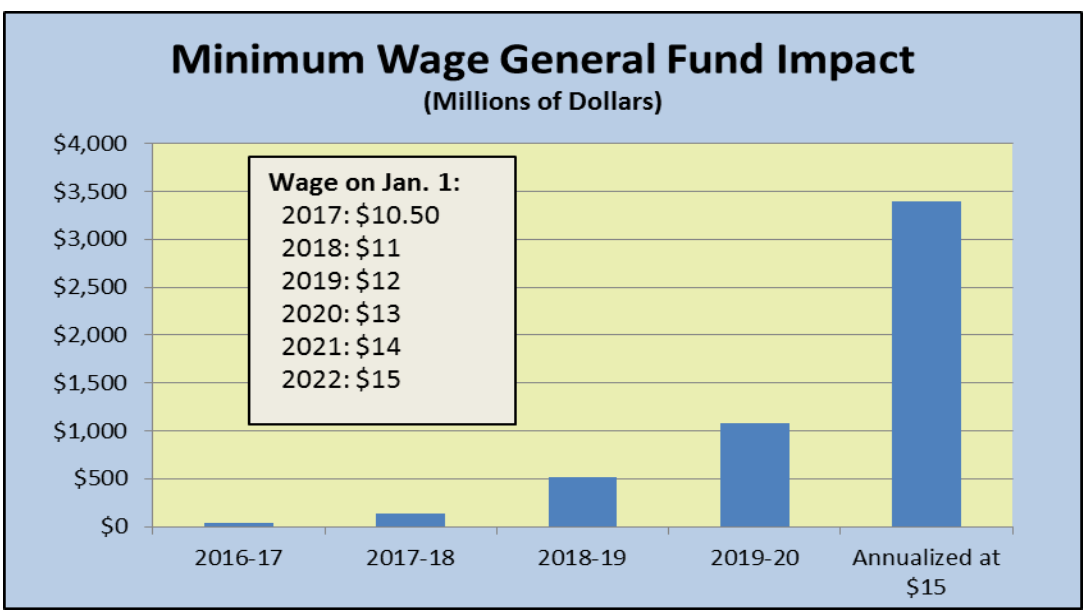
Budget Overview. The May Revision reflects slower revenue growth and avoids major new General Fund spending proposals. The Governor has called again for fiscal restraint, and Senate Republicans hope it is more than a sound bite this time. The Governor already committed to massive future spending increases through the new minimum wage requirement, and legislative Democrats are seeking billions in spending on new or expanded programs. The May Revision also adopts the $2 billion homelessness bond for the mentally ill previously proposed by Senator De Leon.

Key changes in the May Revision compared to the January proposal include the following:

Revenues Grow More Slowly but Still Hit Record High. Revised General Fund revenues would reach $119 billion in 2015-16 and grow by 3.8 percent to over $123 billion in 2016-17. The 2016-17 revenue would be a record high and would exceed the original 2015 Budget Act by $6.5 billion. While revenues are still increasing from year to year, projected growth has slowed by $800 million compared to the January forecast, suggesting the economic tide may be shifting. This softening is largely due to weaker personal income tax revenues associated with lower capital gains. However, even with this revision, General Fund revenue would grow each year through 2019-20, despite the expiration of the temporary Proposition 30 taxes.

Record Spending and Future Deficits. Overall General Fund spending would reach $115.6 billion in 2015-16 and grow by 5.7 percent to a record $122.2 billion in 2016-17. Because of spending growth, including billions in annual costs resulting from the optional Medi-Cal expansion and the recent minimum wage mandate, the Administration now projects a General Fund deficit of $2.7 billion in 2019-20. This looming deficit underscores the need for spending restraint.

Minimum Wage Will Cost State Billions. The May Revision reflects the minimum wage ramp-up, which adds a 50-cent increase on January 1, 2017, with $39 million in General Fund costs for the 2016-17 fiscal year. These costs will increase rapidly, however. As shown in the chart below, the Administration projects annual General Fund costs will be $1.1 billion by 2019-20, when the minimum wage reaches $13 per hour, and $3.4 billion when the $15 wage is fully implemented. These costs would contribute substantially to the projected state deficits in future years.



Rainy Day Reserve Grows More Slowly. The state's Rainy Day Fund (Proposition 2 of 2014) would grow to reach $6.7 billion by the end of 2016-17, or 5.4 percent of General Fund revenue. The weaker income tax revenue growth shrinks the mandatory deposits into the Rainy Day Fund by $1.3 billion overall ($1 billion in 2015-16 and $264 million in 2016-17) compared to the January forecast. Commendably, the Governor continues to propose an extra $2 billion deposit into the Rainy Day Fund. This additional deposit is an essential component in preparing for anticipated economic downturns given the low level of the reserve as a percent of revenue.

Homelessness Bond Added. The May Revision includes funding for the plan announced in January by Senator De Leon to use about 7 percent of existing Proposition 63 mental health revenue for a $2 billion revenue bond to help address the problem of the homeless mentally ill. This new program would spend about $267 million in bond proceeds in 2016-17. The Governor proposes to couple this bond with legislation seeking to restrain development costs by requiring "by right" land use entitlements for multifamily infill housing developments that include affordable housing. Overall programs for affordable housing would total $3.2 billion in state and federal funding. Senate Republicans support efforts to address homelessness and believe that a $2 billion bond could be a prudent use of existing funds, pending review of the proposal's details.

Higher Education. The May Revision adds a proposal to provide $25 million in assistance for the California State University to increase four-year graduation rates, which may help get students out into the workforce faster. Other Higher Education proposals are largely unchanged since January.

K-12 Education. The Proposition 98 minimum funding guarantee would rise to $71.9 billion, an increase of $288 million in 2016-17 compared to the January estimate, including an additional $166 million for education mandates. The May Revision also adds $10 million for grants to universities to develop a four-year path for students to obtain a degree and teaching credential, compared to the typical five-year path typically available today. The Governor also maintains his January proposal to repackage existing preschool and other funds into an early education grant program, but would delay implementation until 2017-18 to allow for more planning.

Infrastructure: Sacramento Offices vs. Roads for Everyone. While California's infrastructure needs are vast, the May Revision maintains the Governor's January proposal to spend $1.5 billion one-time on pay-as-you-go renovations to office buildings in Sacramento. Senate Republicans believe there are greater infrastructure needs, such as roads, and have already called for a portion of these funds to be redirected to restore more than $750 million in expected reductions to transportation projects that have been announced.

Managed Care Organization (MCO) Revenue. The May Revision reflects net revenue increases of $1.1 billion resulting from the MCO package. These revenues free up General Fund from Medi-Cal to be used elsewhere in the budget. In addition to spending previously authorized as part of the MCO package of legislation, the Administration now proposes $266 million to pay for restoring a previous 7 percent reduction to the In-Home Supportive Services program.

Services for the Developmentally Disabled. The May Revision reflects additional General Fund spending of $297 million to improve care for the developmentally disabled. These funds were authorized as part of legislation enacted during the recent special session. However, the budget still does not address unfunded mandates such as costs for exempt employees whose pay must be adjusted under minimum wage mandates.

Cap and Trade Proceeds Despite Legal Questions. The May Revision continues the Governor's January Cap and Trade proposal to spend $3.1 billion on current programs such as high-speed rail, housing, and transit as well as new programs meant to achieve post-2020 greenhouse gas reduction goals. Senate Republicans obtained a legal opinion from the nonpartisan Legislative Counsel in April indicating that the Governor lacks legal authority to use these funds for goals that are not established by law. It is disappointing that the Governor is pressing forward despite this dark legal cloud.

Transportation. The May Revision continues the Governor's $3.6 billion transportation plan, including $3 billion in new taxes and fees, and adds a feature that may make the plan worse: another $193 million for a CalTrans program that the Legislative Analyst's Office has already called overstaffed. In 2015 Senate Republicans proposed a plan which would provide $3.3 billion annually, plus $2.5 billion one-time, for California's roads and highways without increasing taxes.

Revenues

Revenue Growth Still Strong, Despite Modestly Lowered Expectations. The Governor's May Revision decreases the January General Fund revenue projections by a total of $1.9 billion over three fiscal years (2014-15, 2015-16, and 2016-17), but overall General Fund revenues still grow each of these years. General Fund revenues for 2016-17 would grow by 3.8 percent and reach $123.4 billion, yet another record high. This would be $36.3 billion higher compared to the depth of the recession in 2011-12.

Despite these modestly lowered expectations, California lawmakers find themselves in an unexpectedly solid position today compared to a year ago. Compared to June 2015 when the previous Budget Act was passed, the state today finds itself with an unanticipated $4.4 billion in revenue over the three-year period. Although Proposition 98 and Proposition 2 automatically direct some of these revenues, the Legislature still has substantial additional resources that were not contemplated a year ago.

Total Revenues and Transfers	2015 Budget Act	Governor's May Revision	Forecast Change	%△
2014-15	$112,913	$113,769	$856	0.8%
2015-16	$116,887	$118,815	$1,928	1.6%
2016-17	$121,791	$123,372	$1,581	1.3%
Change to Estimate over 3-year Window			**$4,365**	

Adjustment Primarily Due to Personal Income Taxes (PIT). The largest influence on the revised General Fund revenue figures is weaker personal income tax receipts compared to January. As shown in the chart below, most of the decline in the personal income revenues is limited to the current fiscal year (2015-16). The Administration attributes this decrease to lower capital gains realizations and a lower-than-estimated concentration of income in the high-income tax brackets.

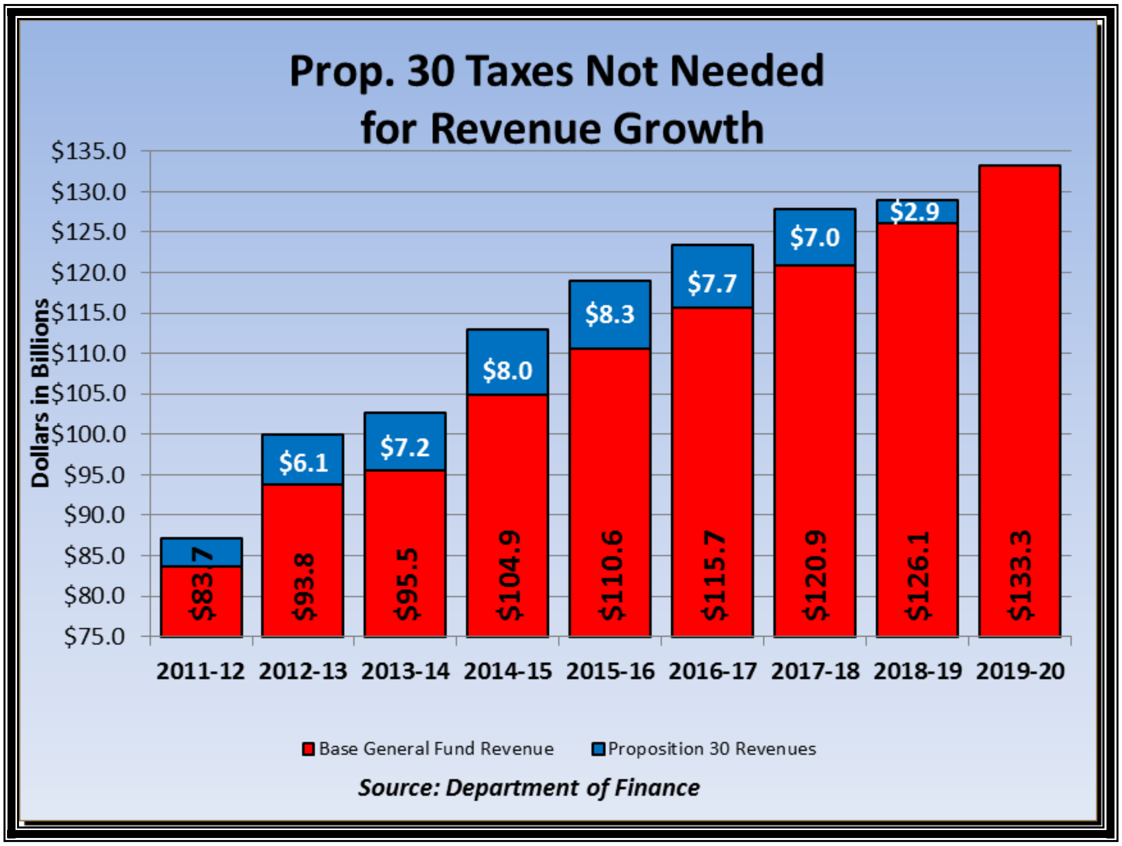
Personal Income Tax	May Revise	Governor's Budget	Forecast Change	%△
2014-15	$76,169	$76,079	$90	0.1%
2015-16	$79,962	$81,354	-$1,392	-1.7%
2016-17	$83,393	$83,841	-$448	-0.5%
Change to Estimate over 3-year Window			**-$1,750**	

Apart from the PIT changes, Sales and Use taxes are down by about $460 million over the three-year period, although this decline is roughly offset by an increase of $452 million in Corporate taxes.

Proposition 30 Taxes Not Needed for Revenue Growth. 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.

Despite calls to extend the temporary taxes, the revised revenue forecasts show that Proposition 30 is simply not necessary to keep state revenues growing. As shown in the chart on the next page, the Administration projects that even with the expiration of Proposition 30, General Fund revenues would grow every year in the forecast period and would reach $133.3 billion by 2019-20. Revenue growth would average 2.9 percent a year during that time and would grow by 3.3 percent in 2019-20, the first year without any Proposition 30 revenue.

Furthermore, the non-partisan Legislative Analyst Office estimates 2-3 percent higher General Fund revenue growth from 2018 through 2020, resulting in an additional $2 billion to $4 billion per year. This steady growth demonstrates that what threatens California's fiscal stability is not a lack of revenue.



Expenditures

The 2016-17 May Revision includes revised General Fund expenditures of $115.6 billion in 2015-16 and projected General Fund expenditures of $122.2 billion in 2016-17. Despite a downward adjustment compared to the January proposal, overall General Fund expenditures would still grow by 5.9 percent over the 2015 Budget Act, as shown in the table below, and would reach a record high.

General Fund Expenditures by Agency

(Dollars in Millions)

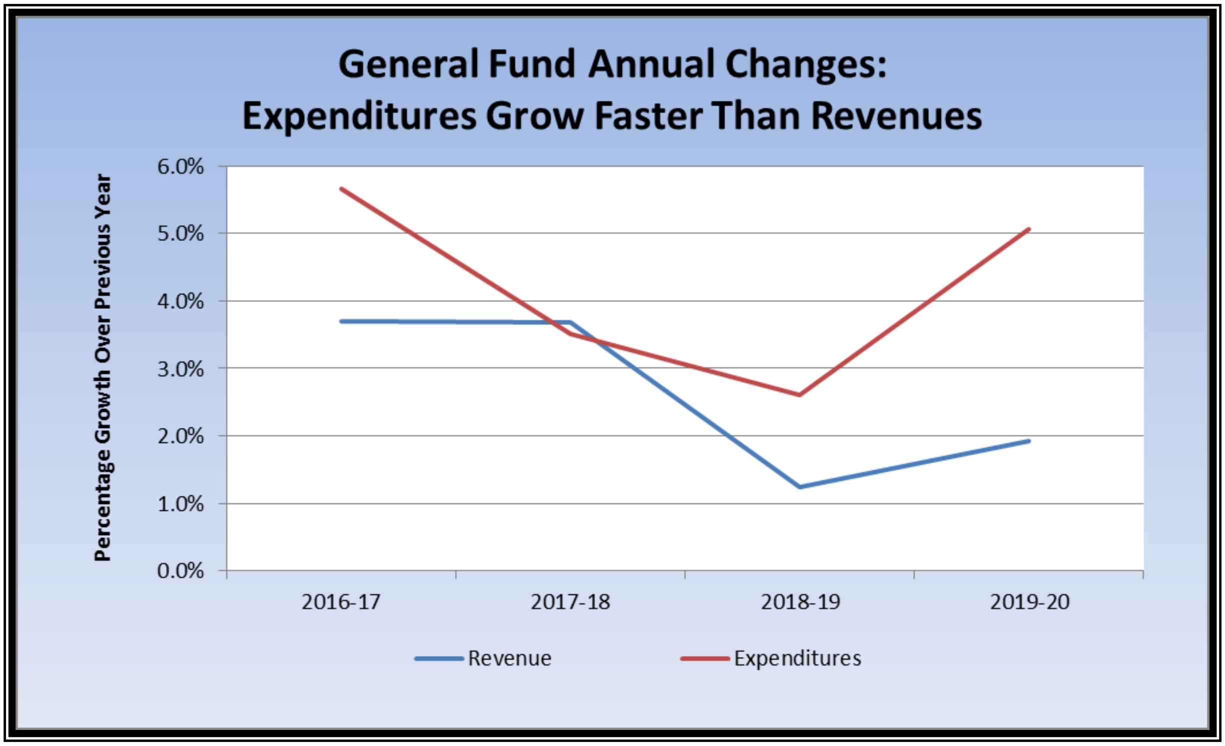
Agency	Budget Act 2015-16	Revised 2015-16	2016-17 Governor's May Revision	Year over Year Change from Budget Act
Legislative, Judicial, Executive	$3,158	$3,245	$3,404	$246
Business, Consumer Services, Housing	$627	$637	$432	-$195
Transportation	$261	$258	$237	-$24
Natural Resources	$2,479	$2,714	$2,801	$322
Environmental Protection	$69	$223	$86	$17
Health and Human Services	$31,867	$31,514	$32,995	$1,128
Corrections and Rehabilitation	$10,078	$10,182	$10,775	$697
K-12 Education	$49,373	$49,566	$51,200	$1,827
Higher Education	$14,200	$14,275	$14,300	$100
Labor and Workforce Development	$214	$212	$173	-$41
Government Operations	$738	$761	$2,256	$1,518
General Government/Other	$2,305	$2,028	$3,496	$1,191
Total, General Fund Expenditures	**$115,369**	**$115,615**	**$122,155**	**$6,786**
Percentage Increase from 2015 Budget Act		0.2%	5.9%	

Source: Department of Finance, Schedule 9.

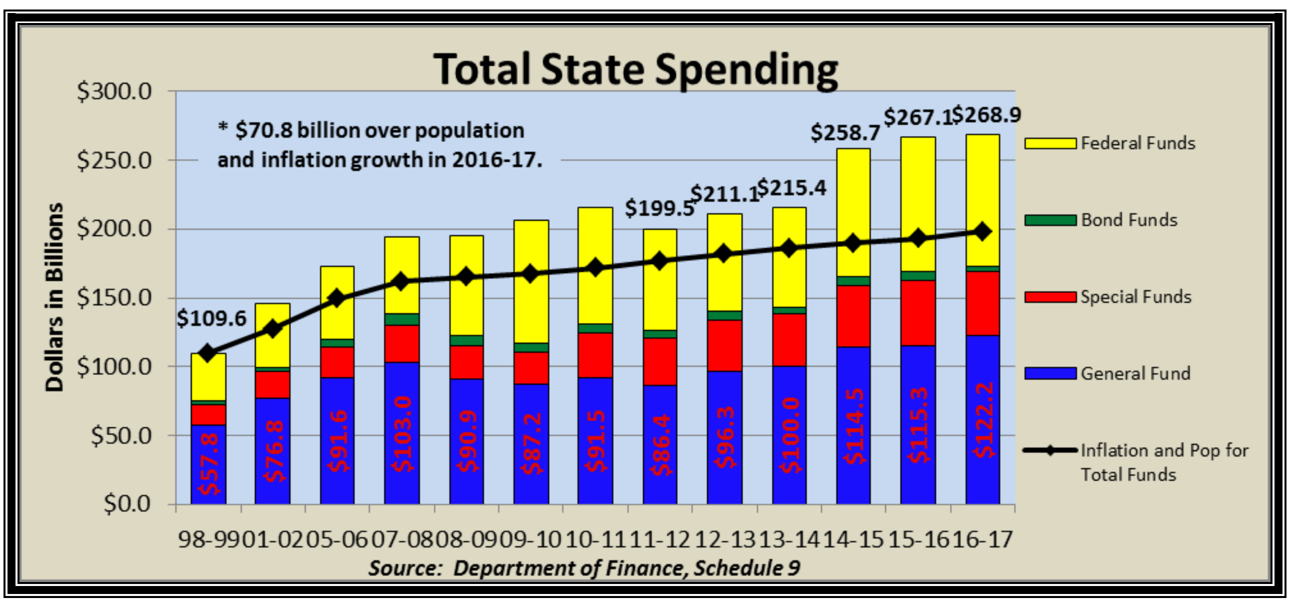
Note 1: The "Government Operations" category includes $1.5 billion in one-time infrastructure spending in 2016-17.

Note 2: The "General Government/Other" category includes a variety of small departments, tax relief, and statewide proposals such as $514 million in 2016-17 for employee compensation adjustments and health and dental benefits for annuitants.

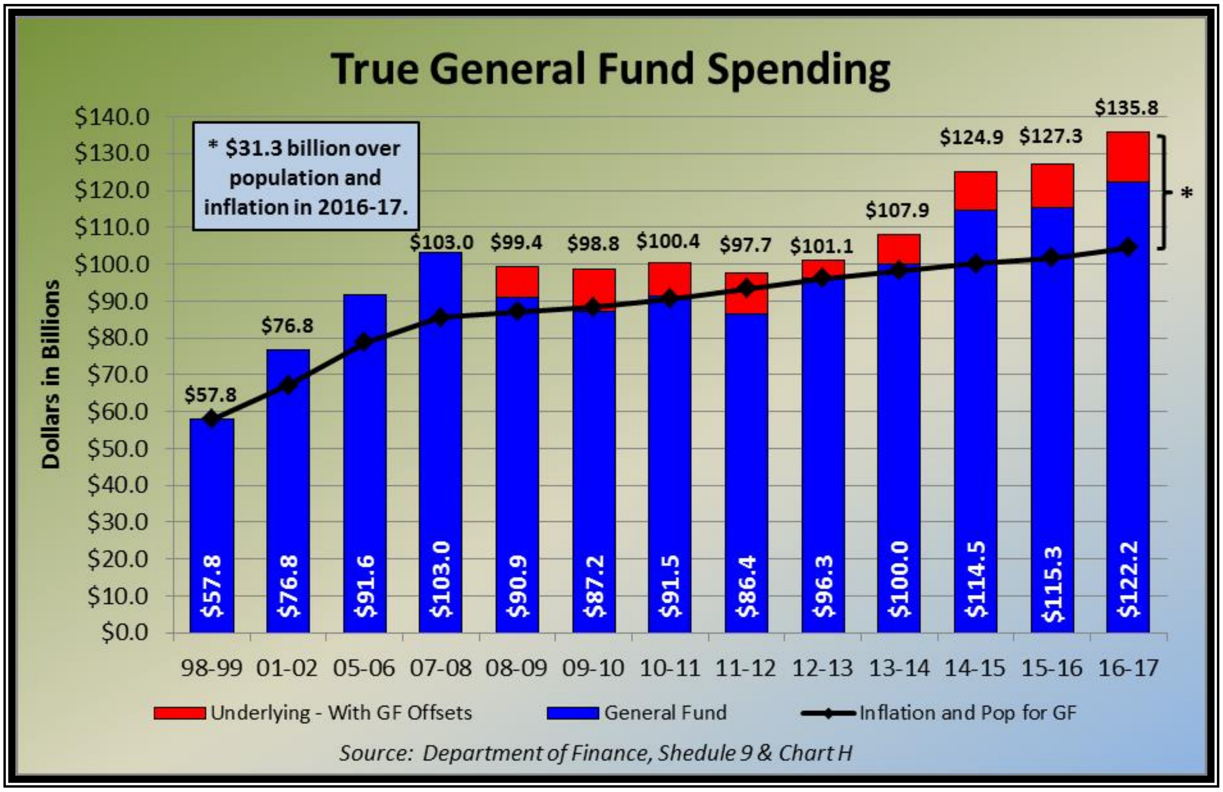
Expenditure Growth Threatens Fiscal Stability. In addition to strong growth for 2016-17, the May Revision predicts expenditures will continue to increase at a rapid clip through 2019-20. As shown in the chart on the next page, General Fund expenditures will generally grow faster than revenues over that period. Driven by policy changes including the new minimum wage mandate (discussed further on page 9), it is this excess expenditure growth that threatens the state's financial condition. The Administration forecasts operating deficits of $1.7 billion in 2018-19 and $4.1 billion in 2019-20, along with an overall General Fund deficit in 2019-20 of $2.7 billion (which accounts for reserves apart from the Rainy Day Fund). These looming deficits underscore the need for spending restraint.



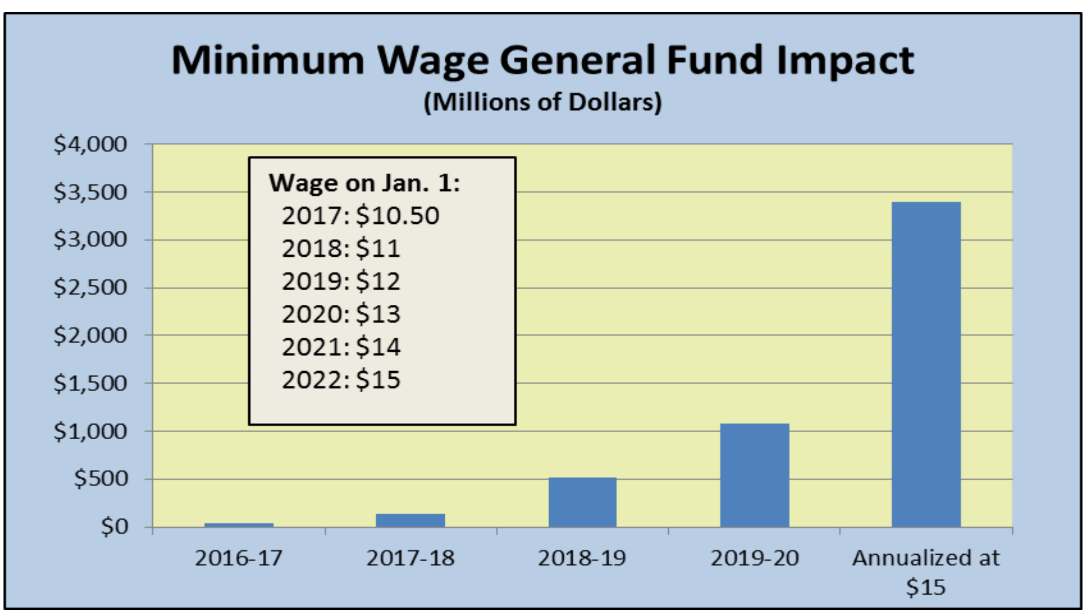
Fund Shifts Mask Real Budget Growth. General Fund spending is only part of state spending. In addition to the $122.2 billion in General Fund, the Governor's May Revision proposes the expenditure of $47.1 billion in special funds, $3.8 billion in bond funds, and $95.8 billion in federal funds. As shown in the following chart, **the total state spending for 2016-17 is $268.9 billion.**



Since the recession, the Democrats have altered spending to shift many programs off the General Fund and on to special funds. In fact, true General Fund program spending, which includes fund shifts, transfers, and various General Fund offsets, never dropped more than five percent less than 2007-08 spending. **When accounting for all of these offsets, true General Fund program spending has increased to $135.8 billion, which is $32.8 billion higher than it was before the great recession.**



Minimum Wage a Big Driver of Future General Fund Spending. The Governor acknowledges that one of the new major spending commitments is the ramp-up to a $15 minimum wage by 2022. According to the Administration, the 2016-17 General Fund cost from the first increase to $10.50 an hour starting on January 1, 2017 will be $39.4 million. As shown in the following chart, those costs dramatically increase to more than $1 billion by 2019-20 (the last fiscal year included in the forecast). The Governor estimates that once the $15 per hour minimum wage is fully implemented beginning in 2022, annual General Fund costs will be roughly $3.4 billion. (Businesses with fewer than 25 employees have an additional year to adjust wages). Most of these costs will be borne by the In-Home Supportive Services program and developmental services programs, and some reductions in Medi-Cal and CalWORKs enrollment are assumed.



Proposition 2 Rainy Day Fund

The May Revision demonstrates that the Rainy Day Fund (RDF) approved by California voters in 2014 is working. As shown in the table below, the budget would transfer $1.3 billion to the RDF and allocate $1.3 billion for debt reduction, as required by Proposition 2. Although the RDF deposit amount is lower than the January estimate by $264 million, this adjustment and a $1 billion adjustment to the 2015-16 deposit (not shown in the table) help smooth out the downward revision to the revenue estimates. In addition, the up-front 1.5 percent set-aside that Republicans negotiated as part of Proposition 2 will contribute $7.7 billion of the RDF amounts over four years. This is a far more stable contribution than the capital gains portion, which the Governor projects would decline to zero by 2018-19.

Rainy Day Fund Forecast

Dollars in Millions

	2016-17			Forecast			
	January	May	Change	2017-18	2018-19	2019-20	Total
Annual 1.5% of General Fund Revenues	$1,863	$1,851	-$12	$1,919	$1,935	$1,999	**$7,704**
Capital Gains Taxes in Excess of 8% of General Fund Revenues	$1,249	$733	-$516	$356	$0	$0	**$1,089**
Rainy Day Amounts Available	**$3,112**	**$2,584**	**-$528**	**$2,275**	**$1,935**	**$1,999**	**$8,793**
Required Debt Repayment (50%)	$1,556	$1,292	-$264	$1,138	$968	$1,000	**$4,398**
Required Deposit to Rainy Day Fund (50%)	$1,556	$1,292	-$264	$1,138	$968	$1,000	**$4,398**
Additional Rainy Day Fund Deposit	$2,000	$2,000	$0	$0	$0	$0	**$2,000**
Total Rainy Day Fund Deposit	**$3,556**	**$3,292**	**-$264**	**$1,138**	**$968**	**$1,000**	
Rainy Day Fund Balance at End of Year [1]	**$8,011**	**$6,713**	**-$1,298**	**$7,851**	**$8,819**	**$9,819**	
Balance as % of General Fund Revenue	**6.5%**	**5.4%**	**-1.1%**	**6.2%**	**6.9%**	**7.4%**	

1. Includes beginning balance of $3.4 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, May 2016

Critical Extra Deposit Maintained. The May Revision continues to propose a $2 billion deposit beyond the required amount, which would bring the 2016-17 RDF balance to about $6.7 billion, or 5.4 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 3.8 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 7.4 percent of revenue by 2019-20, still less than the constitutional limit of 10 percent. The Governor also proposes an unrestricted, non-RDF reserve of $1.8 billion, for a combined reserve of $8.5 billion. Legislative Democrats are likely to view both the unrestricted reserve and the extra $2 billion RDF deposit as potential spending sources.

The Administration has proposed budget bill language to clarify that the supplemental $2 billion deposit would be protected by Proposition 2's standard withdrawal limitations. This is an important clarification that would help 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, as voters intended.*

Education

Proposition 98 funding for K-14 education continues to grow. The chart below displays proposed 2016-17 Proposition 98 funding for K-14 education, based on the Governor's May Revision revenue estimates. Total Proposition 98 education funding would reach an all-time high of $71.9 billion ($288 million above the January budget proposal), the Proposition 98 maintenance factor obligation would grow to $908 million[1], and average per-pupil K-12 spending would reach $10,657.[2]

Proposition 98 Funding at 2016-17 May Revision

Source: Legislative Analyst's Office

($ in millions)	2014-15 at 2014-15 FBA [2/]	2014-15 at 2016-17 GB [3/]	2014-15 at 2016-17 MR [4/]	2015-16 at 2015-16 FBA	2015-16 at 2016-17 GB	2015-16 at 2016-17 MR	2016-17 GB	2016-17 MR
K-12 education [1/]								
General Fund	$44,552	$44,496	$44,925	$44,035	$44,536	$44,270	$45,442	$45,487
Local property tax revenue	$14,432	$14,834	$14,817	$16,380	$16,560	$16,714	$17,802	$18,009
K-12 subtotal	$58,984	$59,330	$59,742	$60,415	$61,096	$60,984	$63,244	$63,496
California Community Colleges [5/]								
General Fund	$4,975	$4,979	$5,025	$5,300	$5,373	$5,422	$5,447	$5,535
Local property tax revenue	$2,263	$2,302	$2,306	$2,613	$2,624	$2,562	$2,812	$2,760
CCC subtotal	$7,238	$7,281	$7,331	$7,913	$7,997	$7,983	$8,259	$8,295
Other Agencies	$80	$80	$80	$80	$82	$82	$83	$83
Total Proposition 98 [6/]	$66,302	$66,690	$67,153	$68,409	$69,175	$69,050	$71,585	$71,874
General Fund	$49,607	$49,554	$50,029	$49,416	$49,992	$49,773	$50,972	$51,105
Local property tax revenue	$16,695	$17,136	$17,124	$18,993	$19,183	$19,276	$20,613	$20,769

[1/] K-12 education totals include state preschool and related 'wraparound care'
[2/] FBA = final budget act
[3/] GB = Governor's proposed budget
[4/] MR = May Revision
[5/] 2015-16 and 2016-17 CCC display includes $500m for adult ed which can flow to any K-14 provider (not restricted to CCCs)
[6/] Any discrepancies are due to rounding

Preschool block grant delayed. The May Revision continues the January proposal 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 Proposition 98 funding for State Preschool ($878 million) and Transitional Kindergarten ($726 million) into a single, more flexible and locally-controlled funding stream. However, it withdraws the January proposal to fold in $50 million in Quality Rating and Improvement System funding, and would now delay implementation to 2017-18 to provide more time to plan for the transition. The proposed consolidation is worthy of consideration, but care should be taken to ensure that existing private providers be allowed to continue participating in the program.

Child care funding held roughly flat until new federal requirements are known. Despite calls from Democrats for an $800 million increase in non-Proposition 98 child care funding, the May Revision makes few changes to the Governor's January proposal: it continues the January proposal for the Department of Education to examine the feasibility of shifting subsidized child care to a uniform rate structure, deletes the January Cost Of Living Adjustment (COLA), as discussed on the following page,

[1] 2016-17 is expected to be a Test 3 year because General Fund growth is expected to be lower than per-capita personal income growth. The state is allowed to fund Proposition 98 at the lower Test 3 level, but must create a maintenance factor obligation equal to the difference between the Test 3 level and the higher Test 2 level.
[2] 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. $10,657 is an LAO estimate.

and makes some CalWORKs caseload adjustments, but otherwise leaves child care funding roughly flat at around $1.6 billion from all sources. Given that the state's costs to comply with a recent federal child care reauthorization are still unknown but likely to be high, it makes sense to wait until we know more about those compliance costs before committing new funds. In the meanwhile, Senate Republicans endorse efforts such as SB 670, championed by Senator Janet Nguyen (R - Garden Grove) and others, that bypass the child care bureaucracy altogether by incentivizing employers with tax credits for starting and supporting child care programs for their employees and commercial tenants.[3]

New school facilities loans. The May Revision proposes $100 million in one-time Proposition 98 General Fund for a revolving loan program for school facilities with critical health and safety issues. This is a supportable use of one-time funds, given the difficulties created by such issues.[4]

Teacher workforce efforts expand. The May Revision proposes $10 million General Fund for one-time grants to postsecondary institutions to develop four-year integrated teacher credential programs (most such programs now run for five years), and $2.5 million in one-time funds to strengthen statewide teacher recruitment. These are supportable efforts to address the growing teacher recruitment challenges reported by school districts across the state.

Local Control Funding Formula (LCFF) grows to 96 percent 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).
- Supplemental grants worth an additional 20 percent of base grant funding for each low-income student,[5] English learner, or foster youth.[6]
- Concentration grants worth an additional 50 percent of base funding for these same students, to the extent that they exceed 55 percent of an LEA's total enrollment.

The May Revision provides an augmentation of over $2.9 billion (up $154 million from January), bringing locally-controlled funding to over $55.6 billion, or about 96% of the statewide target level. Senate Republicans have supported additional LCFF funding based on its enhancement of local control.

Mandate debt reduction continues. The May Revision proposes over $1.5 billion ($164 million above the January level) to reduce the backlog of unpaid K-14 education mandate claims to about $1.2 billion by the end of 2016-17. These one-time funds, allocated on a per-student basis, 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.

The Un-COLA. The May Revision eliminates the January cost-of-living adjustment (COLA) of 0.47 percent for some programs within Proposition 98, based on subsequent changes to the federal Implicit Price Deflator for State and Local Government, which drives the program COLA. This frees up $61 million for other K-14 education uses, but does not affect overall Proposition 98 funding.

[3] http://cssrc.us/content/senate-republicans-support-family-access-quality-child-care
[4] http://www.times-standard.com/article/NJ/20160208/NEWS/160209857
[5] Poverty is measured by eligibility for free or reduced-price lunches.
[6] A student who falls into one of these three categories is funded the same as one who falls into all three.

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 May Revision proposes to commence this funding with $9.9 million (up from $7.3 million in January) to reduce truancy and support students who are at risk of dropping out of school or are victims of crime. Program specifics will be developed in pending legislation. Because the funds will be spent directly on students, the Administration scores them as part of the Proposition 98 guarantee of funding for K-14 education.

Proposition 39 energy efficiency funding rises. The May Revision provides $448 million (up from $411 million in January and $352 million in 2015-16) for Proposition 39 energy efficiency projects at K-12 schools ($399 million) and community colleges ($49.3 million).

Career technical education (CTE) funding unchanged from January. 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 May Revision maintains the Governor's January proposal to fund the second year of this effort as planned, at $300 million, and to continue providing $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. The May Revision also maintains the January proposal to provide a $248 million augmentation 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. Senate Republicans would like to see CTE funding continue to grow along with the growth in Proposition 98 resources.

Charter school startup program shifted to California School Finance Authority. The May Revision maintains the January budget proposal to provide $20 million in one-time funding for charter school startup costs, backfilling the loss of a federal grant that previously met this need. However, it now proposes to run the program through the California School Finance Authority rather than the Superintendent of Public Instruction. Senate Republicans have been generally supportive of charter schools, which provide alternatives for families dissatisfied with traditional government schools. The proposed shift to CSFA is supportable, as that entity has done a good job with its existing charter school facilities program.

No school facilities bond deal. In his January budget, the Governor objected to the $9 billion K-14 education facilities bond initiative that has qualified for the November 2016 statewide ballot, based on its cost, complexity, and lack of flexibility. He proposed 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.[7] However, no deal was struck, so the November 2016 ballot initiative stands as the only vehicle for providing future state school facilities bond funds.

California Community Colleges (CCCs). The May Revision increases the CCCs' share of Proposition 98 funding to $8.3 billion in 2016-17, $36 million above the January level.[8] Notable augmentations continued from January include:

- $200 million for 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

[7] More detail is provided starting on page 50 here: http://www.ebudget.ca.gov/2016-Infrastructure-Plan.pdf
[8] CCC funding includes $500 million for adult education, which can flow to any K-14 education agency.

- $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 adjustments shown above and the mandates and energy-efficiency funding discussed earlier in this section, other notable changes from the January proposal include:

- $189 million in one-time funding for deferred maintenance and instructional equipment (down from $255 million in January)
- $75 million for a general purpose apportionment increase (up from zero in January)
- $41 million for supplemental financial aid (up $2.2 million from January, due mostly to the addition of Cal Grant C recipients)
- $20 million in one-time funding to expand student access to online courses
- $12 million ($7 million one-time and $5 million ongoing) for technology infrastructure
- $5 million for adult education technical assistance
- $1.7 million to increase the state rate paid for apprenticeship programs to that paid for credit instruction (down $136,000 from January due to elimination of a COLA)
- No COLA for apportionment funding (down from $29.3 million in January)

Finally, the following significant augmentations are unchanged since January:

- $115 million for two percent enrollment growth
- $30 million to expand the Basic Skills Initiative to assist unprepared students to successfully transition to college-level math and English coursework
- $25 million for awards to incentivize innovations in technology and data, effective transfer pathways, and transitions into the workforce
- $10 million for the Institutional Effectiveness Partnership Program, which assists CCC districts that are struggling with student performance issues, 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

UC, CSU, and Student Financial Aid

As the chart below shows, the May Revision generally maintains the Governor's January budget proposal by offering modest increases for University of California (UC) and California State University (CSU) through continued implementation of a four-year funding plan known as the 5-5-4-4 plan that began in 2013-14.

UC and CSU Funding at 2016-17 May Revision
(Core funds, in millions)

	Fund	2014-15 at GB	2014-15 at MR	2015-16 at GB	2015-16 at MR	2016-17 at GB	2016-17 at MR
UC	General Fund [1,2,3]	$2,993	$2,993	$3,257	$3,259	$3,467	$3,471
	Tuition and Fees [4]	$3,998	$3,998	$4,112	$4,112	$4,300	$4,300
	Other UC Core Funds [5]	$240	$240	$240	$240	$240	$240
	Lottery	$32	$32	$33	$33	$33	$33
	Total UC	**$7,263**	**$7,263**	**$7,642**	**$7,644**	**$8,039**	**$8,044**
CSU	General Fund [1,2,3,6]	$3,042	$3,042	$3,297	$3,297	$3,484	$3,510
	Tuition and Fees [4]	$2,905	$2,905	$2,929	$2,929	$2,956	$2,956
	Lottery	$55	$55	$51	$51	$51	$51
	Total CSU	**$6,002**	**$6,002**	**$6,277**	**$6,277**	**$6,491**	**$6,517**
	Grand Total	**$13,265**	**$13,265**	**$13,918**	**$13,921**	**$14,530**	**$14,561**

Note: this chart reflects January estimates of of tuition and fees, other UC core funds, and lottery funds.

GB = Governor's January Budget. MR = May Revision.

1/ Includes general obligation bond debt service.

2/ 2016-17 includes $35 million one-time funds each for UC/CSU deferred maintenance at GB.

3/ 2014-15 includes Awards for Innovation in Higher Education funding

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.

Source: Legislative Analyst's Office

University of California (UC). Based on recent actions taken by UC, the May Revision acknowledges the release of two contingent appropriations included in the 2015 Budget Act: (1) a $25 million ongoing augmentation in recognition of UC's admission this spring of 5,000 more resident undergraduates in fall 2016-17, and (2) a $96 million one-time payment from Proposition 2 funds to the UC Retirement Plan in recognition of the Regents' adoption of reforms that limit UC employees' pensionable income to amounts consistent with the Public Employees' Pension Reform Act of 2013. In addition to these current-year actions, the May Revision proposes $4 million in new one-time funding for development of new courses to fulfill UC's A-G subject admission requirements[9] and continues the following augmentations proposed in January:

- $171 million in Proposition 2 Rainy Day funds for a second deposit to the UC Retirement Plan in recognition of recent pensionable income reforms
- $125 million for a four percent increase in General Fund support, consistent with the "5-5-4-4" plan launched in 2013-14 to give UC specific General Fund increases over four years
- $35 million in one-time funding for deferred maintenance
- $25 million in one-time Cap and Trade funding for energy projects

[9] http://www.ucop.edu/agguide/a-g-requirements/

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. Senate Republicans support a continued freeze on UC tuition, and priority enrollment for Californians.

California State University (CSU). The May Revision proposes (1) $25 million in one-time funding contingent on the Trustees' development of plans to increase CSU graduation rates to those of comparable institutions and to close the graduate rate gap between low-income students and other students, and (2) $1.1 million in ongoing funding for a Student Success Network intended to improve student outcomes across all campuses. In addition, it continues the following augmentations proposed in January:

- $35 million in one-time funding for deferred maintenance
- $35 million in one-time Cap and Trade funding for energy projects
- $125 million for a base funding augmentation, consistent with the "5-5-4-4" plan
- $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. Senate Republicans support a continued freeze on CSU tuition.

Student financial aid grows. The Governor's January budget proposed over $2.2 billion in total funding for student financial aid. The May Revision reduces the estimated demand for Cal Grants by $101.6 million, thereby reducing total financial aid funding to $2.1 billion (still about $137 million above the 2015-16 level). In addition, it proposes a $283 million increase in federal Temporary Assistance for Needy Families (TANF) funding, bringing total TANF funding to $1.1 billion and offsetting an identical amount of General Fund support.

Health

<u>Medi-Cal</u>

The May Revision proposes Medi-Cal General Fund spending of $17.5 billion in 2015-16 and $17.6 billion in 2016-17. The revised 2016-17 estimate is $1.4 billion or 7.5 percent below the January estimate for 2016-17, largely due to the Managed Care Organization (MCO) tax fund shift. Key changes and policies are discussed below.

Managed Care Organization (MCO) Revenues Reflected. The downward adjustment to the proposed Medi-Cal budget is largely the effect of the MCO revenues, which were enacted by the Legislature in February 2016 as part of the Second Extraordinary Session on Health and Developmental Services. The May Revision reflects a fund shift of $1.1 billion within Medi-Cal from the General Fund to the new MCO revenue, which effectively frees up that same amount of General Fund to be spent anywhere elsewhere in the state budget.

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 10 percent in 2015-16 and 4.8 percent in 2016-17. Enrollment in 2016-17 would reach 14.1 million, a significant upward revision in the forecast of 4.7 percent just compared to the January budget. Overall, Medi-Cal in 2016-17 will expand by 6.2 million enrollees or 78 percent compared to 2012-13, primarily due to the ACA. **Following this enrollment explosion, Medi-Cal would cover nearly 36 percent of the California population in 2016-17.**

Beginning in 2016-17, California will 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 $820 million General Fund for the half year, reflecting an increased estimate of $80 million compared to January. The state share will increase to 10 percent by 2020, when it may reach $2 billion or more.

Provider Rates and Benefit Restorations Still Missing. Based on the May Revision, the savings from the previously enacted 10 percent reductions are estimated to be $167 million General Fund in 2016-17. The rates were restored for some provider types, including dentists, but clinics, medical equipment, physicians, and pharmacy are still subject to the reductions. Even with the cuts restored for some providers, access to care for Medi-Cal enrollees remains a significant challenge.

An independent report issued by the Little Hoover Commission in April 2016 criticized the quality and access to care provided by Denti-Cal. Senate Republicans have joined with Assembly Republican colleagues in calling for an additional $200 million targeted at raising Denti-Cal reimbursement rates for common procedures to national averages, as reflected in AB 1051 (Maienschein).

Additionally, the Administration and legislative Democrats have neglected to restore key benefits in Medi-Cal that were cut in the recent recession, even while they add billions in costs to expand enrollment. Currently, adults enrolled in Medi-Cal can receive an eye exam, but Medi-Cal will not pay for the actual eyeglass to correct poor vision. Shortcomings like this in core programs should be fixed prior to the state embarking on massive new spending commitments through program expansions. Senator Nielsen has authored SB 1361 to restore the eyeglasses benefit at an estimated cost of $20 million annually.

Restoring rates to help improve access to care and restoring essential benefits like eyeglasses for Medi-Cal patients is consistent with Senate Republicans' focus on fixing major problems with existing programs, rather than embarking on costly major expansions before the state honors its current commitments.

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, and the Administration implemented the expansion effective May 16, 2016. The May Revision revises the January cost estimate upward for 2016-17 by $45 million to $188 million General Fund in 2016-17 and projects enrollment of 185,000 minors.

"Medi-Cal 2020" Waiver Programs. The May Revision includes $2.2 billion in additional federal funds associated with the new "Medi-Cal 2020" federal waiver. The waiver provides new incentives and methods of funding services, including Whole Person Care Pilots, the Global Payment Program, Public Hospital Redesign and Incentives, and the Dental Transformation Initiative. While there are many moving pieces, the waiver overall is expected to improve delivery of care, and the federal funds help relieve pressure for additional state costs.

Federal Managed Care Regulations. The May Revision notes that newly released federal regulations for Medicaid managed care plans are likely to drive costs significantly higher for California in the next several years. The May Revision proposes $5 million just for administrative resources to determine the effects of the regulations, but future costs could reach hundreds of millions of dollars annually.

Developmental Services

The May Revision estimates that the Department of Developmental Services (DDS) will serve over 303,000 developmentally disabled (DD) Californians in 2016-17 in community settings and institutional developmental centers (DCs), a slight increase compared to the January forecast. Except for 847 residents in DCs, all of these individuals receive services in community settings, where caseload would increase by 4.2 percent in 2016-17 over the current year. Projected costs would reach $6.7 billion ($4.0 billion General Fund), an increase of $328 million and 5.1 percent compared to the January proposal for 2016-17.

New Resources for Community Services. The May Revision includes $287 million General Fund ($473 million total funds) authorized by Chapter 3, Statutes of 2016 (AB X2 1), which the Legislature enacted in February. The May Revision proposes another $6.6 million General Fund for related changes, including overseeing cultural programs and integrated employment activities and contracting for a provider rate study. These funds build upon the Governor's January proposals to provide $63 million for residential home rates and regional centers, and will provide badly needed additional resources. However, Senate Republicans remain concerned that these increases do not fully address the funding and systemic challenges facing DD individuals, providers, and regional centers. In addition, benefit cuts to services enacted during the recession have not yet been restored, such as caps on respite services and a prohibition on camps and social recreation services. **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.**

Full Minimum Wage Costs Not Funded. The May Revision includes $12 million General Fund to reflect the 50 cent increase in the minimum wage, effective January 1, 2017, mandated by SB 3 (Leno). The Administration projects that DDS costs would reach $1.7 billion General Fund annually once the $15 wage is fully adopted. However, even these exorbitant costs fail to reflect all the effects of the minimum wage. State law requires businesses to pay "exempt" employees (who are salaried rather than hourly) twice the minimum wage. Providers have no option to pay these employees any less, but the Administration has not committed to cover these costs. In contrast, the Administration did include costs to raise salaries for exempt state employees, as well as cost adjustments to avoid "compaction" of pay among supervisors and staff, when calculating the minimum wage effects on the state. **Senate Republicans believe that providers who care for developmentally disabled individuals deserve to be treated as well as state employees and that the Administration should recognize the full effect of state mandates.**

New Loss of Federal Funds. Within hours of the release of the May Revision, DDS learned that federal regulators will withhold over $24 million in funds for Sonoma Developmental Center, based on its failure to meet health and safety requirements. This loss of funds is not reflected in the May Revision DDS budget, and absent other changes, the General Fund would likely be used to pay these DC costs instead. Fairview DC and Porterville DC are also at risk of losing federal funds.

DC Closure Plan Adjustments. The May Revision provides the following updates to plans begun in 2015-16 to close Sonoma, Fairview, and Porterville DCs (with the exception of the secured area at Porterville DC).

- *Additional steps to improve managed care transitions for DC residents moving into community settings.* These proposed "transition requirements" may help ensure that residents transition successfully to the specialized services they need in community settings.

- *Retention Bonuses for State Employees.* This proposal raises some concern because data from the last DC closure indicated that the number of employees decreased at a far slower pace than the number of residents, suggesting that retention is not a problem.

- *Exemptions for DC employees who wish to become community-based providers.* Families of DC residents have expressed support in the past for assisting DC employees in transitioning to the community to continue working with the same residents they served in the DC. This proposal may be prudent, depending on details regarding its implementation.

Human Services

For the 2016-17 fiscal year, the Governor's May Revision provides $29.2 billion ($8.4 billion General Fund) for programs such as Child Welfare Services, In-Home Supportive Services (IHSS), Supplemental Security Income/State Supplemental Payment (SSI/SSP), CalFresh, and CalWORKs administered by the Department of Social Services (DSS). The 2016 May Revision increases spending by $1.2 billion ($614 million General Fund) compared to the January budget, mostly as a result of higher caseload and recent minimum wage increases in IHSS, augmentations for foster care reform efforts, and a CalWORKs grant increase. Following are some of the most notable changes:

New Rate Structure Should Improve Foster Care Delivery. The May Revision continues efforts known as the "Continuum of Care Reform" within the state's foster care system. The reform efforts include a paradigm shift from traditional group homes as a long-term placement to short-term residential treatment centers as an intervention. The efforts seek to improve the assessment of children and families in order to make more appropriate initial placement decisions; emphasize home-based family care; support placement with available services; change the goals for group home care placement; and increase transparency for child outcomes. The reform establishes a core practice model to govern all services, whether delivered by a county or licensed provider, and provides required medically necessary mental health services to children regardless of their placement setting.

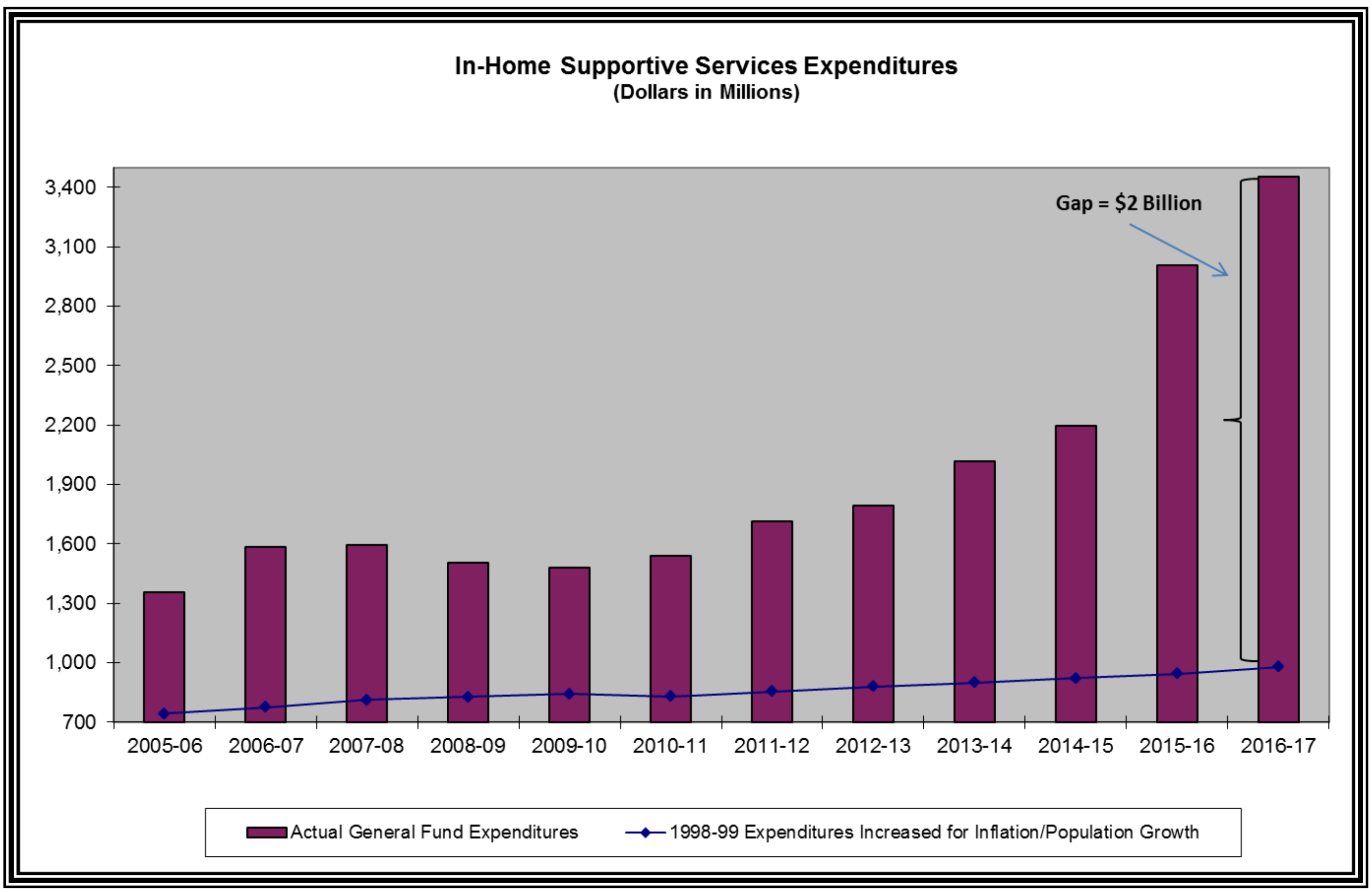
The Governor's May Revision includes an increase of $6.4 million General Fund within the Department of Health Care Services for county mental health costs associated with the reform efforts, including participation in child and family teams, mental health assessments, and training for mental health providers. The May Revision also includes an increase of $60 million General Fund within DSS for implementation of the new home-based family care rate structure ($33 million General Fund), administrative costs for county case planning, recruitment and retention ($25 million General Fund), and training for social workers, probation officers and county mental health staff ($2 million General Fund). Providing a rate that incorporates services as well as board and care will allow foster youth to remain in a home-based setting, maintaining a family-like structure while receiving the necessary array of services and supports needed to grow into self-sufficient, successful adults.

Restoration of IHSS Hours Through MCO Tax. The May Revision reflects a shift in the funding to restore the seven percent IHSS hours reduction from the MCO tax fund to state General Fund, increasing costs in 2016-17 by $571.8 million ($265.8 million General Fund) compared to the Governor's January budget. The budget also assumes the restoration will remain in effect as long as the MCO tax is operational. Senate Republicans have expressed concern with the rapidly growing costs of the IHSS program (see chart below) and the lack of strong program integrity resources. Counties will not share in any additional program costs due to the misguided maintenance-of-effort (MOE) policy implemented in 2011-12 that capped the counties' IHSS costs at the 2011-12 level. **The MOE policy is now costing the state $526 million General Fund in 2016-17.**

Minimum Wage Increases Boost IHSS Costs Even Higher. The May Revision includes $18.4 million General Fund to reflect the impact of the first $.50 increase in the minimum wage, effective January 1, 2017. Chapter 4, Statutes of 2016 **(**SB 3, Leno) increases the minimum wage for IHSS providers to $15 an hour by 2023, **increasing the cost of the IHSS program by $1.8 billion** upon full implementation. Additionally, SB 3 authorizes IHSS providers to be paid for three sick days (the program has about 400,000 providers), at a cost of about $230 million upon full implementation. The bill's effect on IHSS is major, as it not only significantly increases the wage paid to IHSS providers (70 percent of whom are family members of recipients) but also moves the bar closer and closer to treating these union members like state workers. In 2014-15 the state began centralized bargaining for IHSS wages and benefits, rather than the previous county-by-county approach, and last year's budget granted overtime rights to IHSS providers. Unfortunately these changes reduce local accountability and primarily benefit a narrow special interest group at the expense of almost everyone else. **Senate**

Republicans would prefer to enact policies that fix long-standing problems with core benefits, such as Denti-Cal, and make California more affordable for all working families, not simply benefit a narrow interest group.

IHSS Overtime Exemptions Begin. The May Revision includes $494 million ($230.3 million General Fund) in 2016-17 for overtime payments to IHSS providers working more than 40 hours a week. The May Revision increases expenditures by nearly $26 million General Fund for costs associated with exempting certain providers from the 66 hour per week restriction, allowing them to work up to 90 hours a week. The budget would allow county social workers flexibility to determine which providers meet this exemption, and as such, costs could be higher than the budget assumes. While trying to carve out exemptions for high-needs recipients may be meritorious, the recently released proposed exemptions for recipients with “extraordinary circumstances” is open to interpretation and leaves the program ripe for abuse. With counties no longer having any fiscal incentive to control IHSS costs (the misguided maintenance-of-effort policy again), this overly flexible exemption could lead to less consistency statewide and significant fiscal risk in a program that is already one of the fastest growing in the state, as shown by the chart below. **Combined with a growing caseload, paying overtime and a $15 an hour minimum wage, IHSS expenditures will eventually crowd out other priorities such as education, infrastructure, and other safety net and public safety programs.**



CalWORKs Grants on the Rise. The May Revision includes $35.4 million from 1991 Realignment Fund to support a 1.4 percent increase to CalWORKs grants, effective October 1, 2016, with full year costs of about $50 million. The new grant levels would be approximately 43 percent of the federal poverty level (FPL). Previous increases (in 2014-15 and 2015-16), as well as the proposed increase, will be funded through the redirection of 1991 realignment general growth revenues. The three grant increases will cost $351.3 million cumulatively in 2016-17. If counties do not have sufficient realignment funding to cover the additional costs, the state General Fund is on the hook for the balance. California is currently one of the most generous states, with grant levels currently ranked the 4th highest in the nation overall and the second highest among the ten largest states. California has a very generous grant and supposedly a focused welfare-to-work program, yet more than half the participants fail to receive a high school diploma. Unfortunately, the Administration and legislative Democrats continue to ignore program reforms that successfully move women and children off welfare and provide them with long-term skills and education. A better approach than simply increasing funding would be providing comprehensive wrap-around services, such as those included in SB 659 (Bates).

Public Safety and Judiciary

Department of Corrections and Rehabilitation (CDCR)

The May Revision proposes 2016-17 General Fund spending for CDCR of $10.3 billion, which is virtually unchanged from the level proposed in January. Adult and juvenile institutional and parolee populations are also flat relative to January projections.

Moderate Funding Increase for Rehabilitative Programming Proposed. In addition to the $82.3 million augmentation proposed in January for rehabilitative programming and reentry contracts and services, the May Revision includes $24.5 million General Fund to further expand rehabilitative opportunities for prison inmates. This funding would be used to:

- Expand and modernize Career Technical Education and other educational programs.
- Expand Arts in Corrections and Cognitive Behavioral Therapy to all institutions.
- Encourage nonprofit organizations to work with inmates in prisons where fewer volunteer programs are available.
- Provide additional in-prison drug treatment opportunities.

As part of its strategy to implement the 2011 Public Safety Realignment (Realignment), CDCR set a goal of improving access to evidence-based rehabilitative programming and ensuring that it provides programming to 70 percent of its target population, consistent with the identified needs of each offender. Nearly five years after Realignment took effect, CDCR has yet to meet that goal. Senate Republicans agree that more program slots and better access to them will likely be needed if CDCR is ever going to meet its goal.

Receiver's Electronic Health Record System Delayed and Over Budget. As part of his turnaround plan of action, the Receiver appointed by the federal courts to oversee the delivery of medical care in the state's prison system is implementing an electronic health record system (EHRS). The EHRS, which has already been partially rolled out, is a critical part of the Receiver's strategy to restore prison medical care to a constitutionally adequate level. He originally planned to develop the system within the existing prison medical budget. However, faulty assumptions about costs and contractual duties were made by both the Receiver's Office and the contractor hired to develop the system, which have resulted in significant project delays and cost overruns. The May Revision includes $80.6 million over a three-year period beginning in 2016-17 so that the project can be completed in August 2017 and fully rolled out by 2018-19.

Unfortunately, the EHRS is not the first major project overseen by the Receiver's Office in which mismanagement and poor planning have resulted in major costs for California taxpayers. In late 2013, shortly after opening the doors of the California Health Care Facility (the prison hospital in Stockton designed by the Receiver), problems began to surface, including a failure of the warehouse system to deliver supplies in a timely manner, filthy laundry piling up, and a scabies outbreak. These problems compelled the Receiver to suspend intake at the new facility for months until they could be sorted out. In addition to these activation problems, the Receiver's Office eventually disclosed that it had seriously underestimated the mobility of the patients to be housed within the facility. This miscalculation resulted in the need to add significantly more permanent custody staff than originally budgeted. In January 2015, we learned that the Receiver had miscalculated the effects of patient acuity on medical staffing requirements. The Budget Act of 2015 included almost $80 million General Fund to nearly double the number of medical staff at CHCF. ***The Receiver, who was appointed by the federal courts to fix California's prison medical system, has bungled several major projects that he designed and for which he is responsible. Republicans believe increased accountability is in order for the***

Receiver and for the costs of federal court mandates regarding prison medical care. To date, legislative Democrats and the Governor have done very little to hold the Receiver accountable.

Proposition 47 Update

Funding Still Well Short of Expectations. Proposition 47 (2014) reduced the penalties for a number of property and drug crimes, directing state savings to programs that reduce recidivism, improve educational outcomes for at-risk students, and expand trauma center services for crime victims. The May Revision reflects estimated first-year savings, and thus includes funding projected to be available in 2016-17 for the programs listed above, of $39.4 million – about $10.2 million above the January 10 estimate. These funds would be distributed as follows:

- $25.6 million (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.
- $9.9 million (25 percent) for a grant program administered by the State Department of Education to reduce truancy at K-12 schools and support students who are at risk of dropping out or who are victims of crime.
- $3.9 million (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.

Even upon full implementation, the Administration's revised projection only assumes annual savings of $62.6 million, which is still well below the $150 million to $250 million annual savings assumption that was used to sell the plan to voters. More recently, the nonpartisan Legislative Analyst's Office estimated that the Administration's January estimate of savings was likely understated by $100 million. In 2014 many Republicans had concerns that Proposition 47's proponents were overselling its benefits, and those concerns now appear well-founded. Nonetheless, accurately accounting for its fiscal effects in the budget is important for allocating funds to programs that may yield some improvements.

Office of Emergency Services

Drought Drives California Disaster Assistance Act Costs Higher. Pursuant to the California Disaster Assistance Act, local governments may request reimbursement from the Office of Emergency Services (OES) for 75 percent of the costs of disaster response and recovery when there is a corresponding proclamation of a state of emergency from the Governor. In October 2015, in response to the ongoing drought, the Governor issued a proclamation of a state of emergency requiring public agencies to identify areas of tree mortality in the state with the greatest potential threat to public safety in terms of wildfires or falling trees. The May Revision includes $30 million to reimburse local agencies for the costs of tree removal in the areas of highest danger due to tree mortality. Poor forest management has long been identified as a major contributor to California's increasingly destructive fire season. To the extent this funding improves the condition of our forests by providing for the removal of excessive fuel, Senate Republicans agree these funds would be a good investment.

Funding Proposal for Earthquake Early Warning System Violates Statutory Prohibition. In 2013, the Governor signed SB 135 (Padilla), which passed both houses of the Legislature with unanimous support. The bill required OES to collaborate with various entities to develop a comprehensive statewide earthquake early warning system and to identify a funding source for the system by January 1, 2016. The bill also made development of the system contingent upon successful identification of a funding source, and specifically prohibited OES from identifying the state's General Fund as that source. Subsequent legislation extended the deadline to July 1, 2016. However, the May Revision includes a proposal from OES requesting $10 million General Fund in 2016-17 to build out the earthquake early warning system. The proposal does not even include, as a formality, trailer bill language to delete the General Fund prohibition. ***Bait-and-switch propositions like this erode taxpayers' trust in their elected officials and violate the Senate Republican fiscal priority of respecting the voters through responsible, transparent government.***

Department of State Hospitals (DSH)

Ongoing Placement Backlog Worsens. Despite augmentations in the last two budget acts for DSH to reduce its backlog of incompetent to stand trial (IST) patients awaiting placement, the backlog continues to grow. It currently stands at about 450, which is up from about 300 at the end of 2014-15 and 150 in 2012. There is now federal litigation pending regarding DSH's failure to place IST patients in a timely manner. Over the past two years, the Department has activated 336 inpatient beds and 108 jail-based competency restoration beds in an attempt to keep up with increasing referrals. The Governor's January budget requested $1.5 million General Fund to establish 10 new jail-based competency treatment beds in Sonoma County. The May Revision requests $20.8 million more General Fund and 176.5 positions to expand jail-based treatment by 25 beds and to activate 96 additional state hospital beds. While these additional beds are clearly necessary, what is troubling is that DSH has been unable to identify the reasons for the steady increase in IST referrals. Without an understanding of what is driving demand for services, it will be difficult for DSH to develop a long-term plan to meet that demand, and the Department will likely face additional litigation in the near future.

Judicial Branch

Investment in the Trial Courts Continues. The May Revision continues to include $226.3 million in additional General Fund support that was proposed in the Governor's January budget. In addition, the May Revision proposes $24.8 million General Fund over three years to replace the case management system in the Superior Courts of Orange, Sacramento, San Diego, and Ventura Counties with commercial off-the-shelf systems. These courts currently use what remains of a failed 2003 procurement project, the Court Case Management System (CCMS). The CCMS was scrapped when, after nearly a decade of development, a State Auditor's report found the project to be poorly managed, lacking independent oversight and validation, and prone to delays and cost overruns that led to project costs in excess of seven times the original estimates. The CCMS system, V3, employed by these four courts is currently supported by funds from the State Trial Court Improvement and Modernization Fund (STCIMF), which has declining revenues and a projected operating deficit. The Judicial Council has determined that, in order to stabilize the STCIMF, all trial courts must self-fund their case management systems by 2019-20. These four courts agreed to be early adopters of CCMS, and in doing so, took a risk that they could end up with a case management system that did not align well with their needs. While they might have been willing to take that risk, they surely did not think they would end up with no case management system at all. The requested funds are a reasonable interim solution that will provide these four courts with a functioning, supportable case management system that they will be able to self-fund by 2019-20 and beyond.

Judicial Branch Improves Compliance with Public Employees' Pension Reform Act. The May Revision includes an augmentation of $7.1 million in 2016-17 ($3.2 million General Fund, $3.9 million special funds) and $14.9 million in 2017-18 ($6.7 million General Fund, $8.2 million special funds) to implement a 7.5 percent general salary increase over two years for Judicial Branch employees. In return, these employees would contribute more toward their own retirement costs, bringing their contributions in line with those of other state employees and the requirements of the Public Employees' Pension Reform Act (PEPRA) of 2013. Senate Republicans pointed out in January 2014 that the Judicial Branch was out of step with PEPRA and applaud the move toward compliance, overdue as it is.

Transportation

The May Revision generally continues the Governor's 2015 Transportation Plan to increase taxes and fees on motorists, with one revision for Caltrans funding.

Caltrans First in Line to Syphon Funds. The May Revision proposes to use $193 million annually, or about 5 percent of the revenues generated by the Governor's plan, for Caltrans to hire about 350 more public sector architects and engineers to develop highway projects. This increase is proposed despite a 2014 Legislative Analyst Office (LAO) report indicating that 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. Senate Republicans believe it is essential to make better use of the funds the state already has before reaching deeper into taxpayers' pockets.

On a positive note, the Governor directs a little more than half of the $193 million to fund contracts for this work, breaking away from the traditional limit of 10 percent of resources for contracting. This is consistent with the Senate Republican perspective that more contractors should be utilized for this program to facilitate staffing adjustments as workload changes.

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. The Governor's proposed increases to gas and diesel taxes, the new road user fee, and the increased registration fee would raise costs for a two-car family by at least $250 a year.

To get California back to basics with great roads and **without raising taxes**, Senate Republicans continue to propose a plan that would provide $3.3 billion annually and $2.5 billion of one-time funding. Below is a summary of the two plans (the Republican plan reflects updated estimates since 2015):

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 by 8.2 cents and index - $500 million annually
- Increase Diesel Excise Tax by 11 cents and index - $500 million annually
- Additional Cap and Trade Proceeds - $500 million
- Caltrans Unspecified Efficiencies - $100 million
- Expedited One-time Loan Repayments over the next four years - $879 million

Senate Republican No-Tax Plan: $3.3 billion annually, $2.5 billion one-time

- Dedicate Weight Fees to Transportation - $1.1 billion annually
- Dedicate Hidden Gas Tax (Cap and Trade) Revenues to Transportation - $2.2 billion annually
- Expedited One-time Loan Repayments - $1.1 billion
- Repayment of Weight Fees Loaned to the General Fund - $1.4 billion

Reduction in Transportation Projects Can Be Avoided. The California Transportation Commission announced in late January that local projects totaling $754 million must be eliminated due to declining gas tax revenues. Senate Republicans believe these projects can be funded through other means. As discussed further on page 38, we believe that a portion of funds that the Governor has proposed for Sacramento office buildings would be put to better use to pay for the transportation projects.

Housing

The lack of affordable housing is one of California's greatest challenges. Although California comprises 12 percent of the nation's population, it has 21 percent of the nation's homeless population, and an even greater share of the chronically homeless, with over one-third of the nation's total. The May Revision takes a step toward addressing a part of these problems in the limited form of a housing bond for the mentally ill, but broader policy changes also are needed to deal with the underlying causes of expensive housing, including ill-advised government policies at the state and local levels.

Bond for the Mentally Ill Homeless Included. The May Revision includes new funding to support the plan announced in January by Senator De Leon, the No Place Like Home Initiative, to use about 7 percent of existing Proposition 63 mental health revenue to secure a $2 billion revenue bond to help address the problem of the homeless mentally ill, with a focus on the chronically homeless population. The May Revision assumes that bonds would be sold over the next seven years and that the new program would spend about $267 million in bond proceeds annually over that time, with $262 million available for capital and operating subsidies, tenant-based rental assistance, and technical grant application assistance to localities. The remaining $5 million annually would be used for the administration of the program. Debt service on the bonds is estimated to be $130 million annually for 30 years, paid from the Mental Health Services Fund.

The Governor proposes to couple the bond proposal with legislation seeking to restrain development costs by requiring "by-right" land use entitlements for multifamily infill housing developments that include affordable housing. This policy will encourage building of affordable housing units, lessening local hurdles for market rate housing builds by exempting qualified developments from specified local permitting and review processes, as long as the development is consistent with the local general plan and zoning standards. Notably, this policy is not dependent upon the proposed bond funds and could be enacted absent the bonds or, conversely, rejected while moving forward with the bonds.

Senate Republicans support efforts to address homelessness and believe that a $2 billion bond could be a prudent use of existing Proposition 63 funds, pending review of the full details of the proposal as part of the budget process. Proposition 63 has suffered from a lack of data, accountability, and transparency, and it appears that some counties may have excess reserves of these funds. Amending Proposition 63 to authorize a bond will require a two-thirds vote in the Legislature, and additional changes to improve accountability or streamline housing development may be warranted.

Broader Policy Changes Needed for Housing Affordability. According to the study *California's High Housing Costs: Causes and Consequences*, released by the Legislative Analyst's Office (LAO) last year, California needs to increase its supply of housing dramatically to make a dent in the need for homes and to reduce the cost of housing. The state already spends $3.2 billion annually on affordable housing as summarized on the following page, and Assembly Democrats have called for an additional $1.3 billion. However, government will not be able to subsidize itself out of the housing affordability problem. According to a supplemental report from the LAO, Perspectives on *Helping Low–Income Californians Afford Housing* released earlier this year, expanding housing assistance to low-income Californians who do not currently receive it would require an annual funding commitment in the low tens of billions of dollars, which the state simply cannot afford.

The type of policy change proposed by the Governor as part of the Proposition 63 bond is a step in the right direction but California will need more policy changes like this on a wider basis to climb out of the affordability crisis.

Figure SLA-01

2016-17 Affordable Housing and Homelessness Funding

(Dollars in Millions)

Department	*Program*	*Amount*
Department of Housing and Community Development	Mental Health Services Act Programs	$267
	Federal Funds	$112
	Housing for Veterans Funds	$75
	Regional Planning, Housing, and Infill Incentive Account	$22
	Office of Migrant Services	$6
	Various	$94
California Housing Finance Agency (CalHFA)[1]	Multifamily Conduit Lending	$300
	Multifamily Lending	$190
	Single Family 1st Mortgage Lending	$1,012
	Mortgage Credit Certificates	$130
	Single Family Down Payment Assistance	$48
	Special Needs Housing Program	$55 [2]
Strategic Growth Council	Affordable Housing and Sustainable Communities	$400 [3]
Tax Credit Allocation Committee	Low Income Housing Tax Credits (Federal)	$225 [4]
	Low Income Housing Tax Credits (State)	$61
	Farmworker Housing Assistance Tax Credits	$5
Department of Veterans Affairs	CalVet Farm and Home Loan Program	$66
Department of Social Services	CalWORKS Housing Support Program	$35
	CalWORKS Homeless Assistance Program	$30 [5]
Department of Finance	Community-Based Transitional Housing Program	$25
Department of Public Health	Housing Opportunities for Persons with AIDS (Federal)	$3
Office of Emergency Services	Homeless Youth and Exploitation Program	$2
California Department of Corrections and Rehabilitation (CDCR)	Integrated Services for Mentally-Ill Parolees	$2
	Specialized Treatment of Optimized Programming, Parole Service Center, Day Reporting Center, Female Offender Treatment and Employment Program	N/A [6]
Total		**$3,165**

[1] Amounts are the estimated lending activities from CalHFA's 2016-17 business plan.

[2] This amount represents a voluntary allocation of Proposition 63 funds from 11 participating counties.

[3] Of the amount appropriated, statute requires at least 50 percent be committed to affordable housing. This program may also fund transportation, infrastructure, and other related uses for projects reducing greenhouse gas emissions.

[4] This amount represents the 9 percent tax credits available in 2016 and an estimated figure for 4 percent credit awards based on 2015. This figure does not include the $3.9 billion of tax-exempt bond debt allocation that is available for award from the California Debt Limit Allocation Committee.

[5] This amount is an estimated figure based on actual assistance provided in 2015.

[6] The state provides a number of wrap-around supportive services through these four programs, including housing support, which cannot be separated from CDCR's general budget.

Source: Department of Finance

Resources & Environmental Protection

Within the Resources, Environmental Protection, and Energy areas, the Administration continues to fund post-2020 greenhouse gas emission (GHG) reduction programs from Cap and Trade revenues, provides additional funding for drought and new water conservation requirements, and makes other noteworthy program proposals.

Governor Continues to Pursue Illegal Expansion of Greenhouse Gas Reduction Goals. The May Revision continues the Governor's January proposal to spend $3.1 billion in Cap and Trade revenues pursuant to the Governor's Executive Order issued in April of 2015 (B-30-15), which is meant to achieve a greenhouse gas (GHG) reduction target for the state of 40 percent below 1990 levels by 2030. SB 32 (Pavley) of 2015, directed at achieving these same goals, failed to pass the Assembly, but the Governor continues to pursue his agenda without legal authority.

Most recently, a ***Legislative Counsel Opinion*** dated April 19th of 2016, specified that:

1. Neither the Governor nor the Air Resources Board (ARB) has the authority to establish a GHG emission limit below the 1990 level that would be applicable beyond 2020 and that the Cap and Trade program may not be applied or used beyond December 31, 2020.

2. The ARB may not increase the Cost of Implementation Fee in order to achieve a statewide emission limit that is below the 1990 level and that would be applicable after 2020.

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 continues to propose programs that would reduce petroleum use by 50 percent and reduce short-lived climate pollutants by 40 percent to 50 percent. 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.** A lawsuit by the California Chamber of Commerce alleges 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.

Ironically, the Governor acknowledged at his May Revision press conference that the program needed to be renewed at some point. Unfortunately, the May Revision fails to acknowledge that expanding the program before receiving legal authorization places a dark legal cloud over the program.

New Executive Overreach Through Water Conservation Order. The Governor issued an Executive Order (B-37-16) on May 9th, 2016, requiring state agencies to update temporary emergency water restrictions and transition to permanent, long-term improvements in water use. The most significant new requirements include:

- The State Water Resources Control Board (SWRCB) shall develop by January 2017 a proposal to achieve a mandatory reduction in potable urban water usage that builds off of the mandatory 25 percent reduction called for in Executive Order B-29-15 through 2016. The Department of Water Resources (DWR) shall work with SWRCB to develop new water use targets as part of a permanent framework for urban water agencies.

- The SWRCB and DWR shall permanently require urban water suppliers to issue a monthly report on their water usage, amount of conservation achieved, and any enforcement efforts.

- SWRCB shall permanently prohibit practices that waste potable water.

- SWRCB and DWR shall direct urban and agricultural water suppliers to accelerate their data collection, improve water system leaks, and prioritize capital projects to reduce water waste.

- DWR shall permanently require the completion of Agricultural Water Management Plans by water suppliers with over 10,000 irrigated acres of land.

The May Revise provides $4.5 million General Fund for DWR and the SWRCB to implement the Executive Order requirements to modernize urban water use efficiency planning standards, develop new enforceable long-term urban water use efficiency targets, and create a new water supplier reporting system. Of this amount, $3 million will be used for remote screening of landscapes areas to measure every parcel of urban and suburban land throughout the state in order to help water agencies meet new water conservation targets. The proposal does not include any new statutory language for the Legislature to consider, meaning these new requirements are under the same dark legal cloud as the previous GHG orders.

Emergency Drought Response Funding Changes. The May Revision increases overall spending by $11.4 million General Fund increasing total funding to $334.5 million ($224 million General Fund) for drought response activities within various departments for the protection of water supplies, water conservation, and emergency response. The updated funding is summarized in the chart below (See page 32).

About $52 million of these funds would provide direct water and food assistance to individuals, while the rest of the funds provide enhanced fire protection, tree mortality assistance, the administration of water curtailment activities, water conservation and drinking water projects, rebates for appliances, and fish and wildlife protection projects.

The May Revision includes the following most significant drought funding changes.

- $42 million General Fund decrease reflecting that removal of salinity barriers in the Delta will not be needed in the fall of 2016

- $30 million General Fund increase to the Office of Emergency Services to provide assistance to counties through the California Disaster Assistance Act, which could be used to assist counties with the removal and disposal of dead trees.

- $11 million General Fund increase to CalFire to assist with the removal and disposal of trees in high hazard areas, consisting of $6 million for grants to locals and $5 million for equipment and overtime pay. ***In addition, legislation is proposed to allow small biomass facilities to defer certain system interconnection costs to accelerate the utilization of biomass materials for energy production in high hazard fire zones.***

- $4.2 million General Fund increase to benefit Delta Smelt ($2 million for habitat restoration and food production, $1.8 million for enhancing aquatic weed control, and $400,000 for modern monitoring and targeted studies).

- $5 million General Fund increase for local assistance for small communities for emergency drinking water support, including addressing private wells.

Senate Republicans appreciate the Governor’s attention to the huge tree mortality problem plaguing California’s forests and the support of biomass facilities that dispose of these materials while generating renewable energy. To achieve healthy forests throughout California, the state will need to contribute even greater funding to continue the removal of dead and diseased trees and reduce the chances that catastrophic wildfires will destroy forests, homes, and habitat.

Emergency Drought Response (Dollars in Millions)				
Investment Category	*Department*	*Program*	*January Amount*	*May Revision Amount*
Protecting Water Supplies	Department of Water Resources	Emergency Salinity Barriers in the Delta	*$42.0*	*$0.0*
	Department of Water Resources	Local Assistance for Small Communities	$5.0	$10.0
	Water Board	Water Curtailment	$5.4	$5.4
	Water Board	Emergency Drinking Water Projects	$16.0	$16.0
Water Conservation	Department of Water Resources	Urban Water Conservation & Save Our Water Campaign	$15.0	$12.0
	Energy Commission	Rebates for Appliances	$30.0	$30.0
	Energy Commission	Water and Energy Technology Program	$30.0	$30.0
	Department of Food and Agriculture	Agricultural Water Conservation	$20.0	$20.0
Emergency Response	Department of Forestry and Fire Protection	Enhanced Fire Protection	$77.4	$87.8
	Department of Water Resources	Tree Mortality	$0.0	$11.0
	Department of Water Resources	Drought Management and Response	$12.0	$12.0
	Department of Fish and Wildlife	Protection of Fish and Wildlife	$17.7	$13.5
	Department of Fish and Wildlife	Delta Smelt Management Strategy	$0.0	$4.2
	Department of Social Services	Drought Food Assistance	$18.4	$18.4
	Office of Emergency Services	California Disaster Assistance Act	$22.7	$52.7
	Office of Emergency Services	State Operations Center	$4.0	$4.0
	Department of Community Services and Development	Farmw orker Assistance	$7.5	$7.5
Total			**$323.1**	**$334.5**

Sustainable Groundwater Management Act (SGMA) Funding. The May Revision proposes $2 million General Fund for (1) DWR to help local public agencies develop effective groundwater sustainability governance structures to implement SGMA and (2) for DWR to support the use of remote sensing technology to establish statewide agricultural land use data to assist local agencies in developing water budgets within basins pursuant to SGMA.

Funding for CalFire Helicopters Lacks Information. The May Revision includes another proposal to fund CalFire helicopters with limited cost information regarding 1) the potential cost of each helicopter, 2) maintenance and operations needs, and 3) possible helicopter facility modifications. According to CalFire, the new request for $12 million General Fund is a starting point to purchase one helicopter in 2016-17. The department acknowledges that more money will be needed to complete the purchase of the first aircraft and has also proposed budget bill language to allow the Department of Finance to augment the funding for the first helicopter and for studies, acquisition, preliminary plans, and working drawings related to future helicopter facility modification needs. The potential augmentation could be completed after a 30-day notification to the Joint Legislative Budget Committee. Although the department needs new helicopters due to the age of its existing fleet, Senate Republicans' concern is that after almost two years of budget discussions, the Legislature still has very limited information on the overall General Fund impact.

Programmatic Priorities at the Department of Parks and Recreation Remain Unclear. After years of struggling to maintain parks and keep them open to the public, the department's goals of increased revenue generation through new programs, projects, and partnerships seems to no longer be a top priority. The Governor's May Revision proposes $348,000 from the State Park's Protection Fund for a new California History Interpretation Pilot Program at California Citrus State Historic Park and El Presidio de Santa Barbara State Historic Park to create culturally relevant interpretive and environmental programs. It is unclear how this pilot project would generate more revenues to make the park system fiscally sound or why this pilot project is one of the department's top priorities. In January, the Governor proposed a $31 million dollar rip-off from the Off-Highway Vehicle Program in order to keep other non-OHV park units open to the public. It would seem that a new pilot program directed at revenue generation in order to make all park units self-sustaining, similar to the OHV program, would be more appropriate.

Safe Drinking Water Account Fee Increase. The May Revision requests trailer bill language to increase the statutory limit on the Safe Drinking Water Account in order to raise fees by $7 million in 2016-17 for the Administration's various budget proposals. This would amount to a 30 percent increase in fee revenues since the Safe Drinking Water Program was transferred to the SWRCB from the Department of Public Health in 2014. Senate Republicans raised concerns about this program's transfer to the SWRCB believing that it would lead to significant fees increases on water ratepayers and now that concern has become a reality.

Special Funds Inappropriately Used to Settle Lawsuit. The Governor's May Revision requests $2 million from the Air Pollution Control Fund penalty revenues to pay the remainder of a $10 million dollar lawsuit against the State of California. This proposal also acknowledged that the first $8 million of the lawsuit was funded from numerous other special funds that support CARB, such as, the Motor Vehicle Account, Cost of Implementation Account, Air Quality Improvement Fund, and the Greenhouse Gas Reduction Fund. The use of fee revenues to pay for lawsuits caused by CARB employees is inappropriate and violates Proposition 26, which requires fee payers to receive a direct benefit from the fees they pay. Therefore, the funding of this lawsuit should be paid from the General Fund.

Local Government

New Election Mandate Funding

The Governor's May Revision includes $626,000 to cover the costs of a newly recognized state reimbursable mandate to manually tally post-election ballots in contests in which the margin of victory was very narrow. In 2008, counties were required to conduct manual tallies in ten percent of precincts for the affected contests. This request follows Senator Janet Nguyen's successful bipartisan effort in the budget subcommittee process to approve $77 million to reimburse counties for six previously suspended elections mandates. Funding these costs will help reduce election fraud. **Senate Republicans urge the Governor and legislative Democrats to include these funds in the final budget and to reactivate these important laws that would help make sure every vote counts in the upcoming November Presidential election.**

Siting Incentive Grants

The Governor's budget included $25 million to provide incentives to cities and 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. The Governor's May Revision adjusts this proposal to provide "grants" rather than "incentive payments" and eliminates the narrow timeframe for local governments to approve permits. This will likely encourage more participation in the program by local governments. **Senate Republicans have worked hard to ensure that local governments have the tools and resources necessary to protect their communities.**

Wildfire Relief

The Governor's May Revision makes no changes to the proposals to aid Lake and Calaveras counties in their recovery from two devastating wildfires that burned more than 145,000 acres and destroyed more than 2,000 homes and other structures. Those proposals provided:

- $1.9 million to backfill lost property tax, sales and use tax, and transient occupancy tax revenues in 2016-17.
- CalFIRE fire protection contract relief for the South Lake County Fire District and Calaveras County (totaling nearly $2.9 million in 2016-17).

Employee Compensation

Collective Bargaining Continues. The Administration is currently negotiating with 17 of the state's 21 bargaining units (BUs). Chapter 12, Statutes of 2016 (SB 95) included provisions of the contract agreement between the state and BU 6, represented by the California Correctional Peace Officers Association. The contract includes the Administration's strategy for addressing the $74 billion unfunded liability for retiree health benefits, including equal cost-sharing, extension of time worked to qualify for benefits, and a reduced employer subsidy for retiree health benefits. The changes expected to be included in the other BU agreements should also reduce the unfunded liability while curtailing the growth of health care costs in the future, a commendable policy that Senate Republicans have been recommending for several years.

Concessions Come with Significant New Costs to the State. The May Revision includes expenditures of $362 million ($314 million General Fund) above the January Budget for increases in wages and health benefits for state employees. The additional costs are driven by the recently negotiated BU 6 agreement and pay increases related to minimum wage changes in Chapter 4, Statutes of 2016 (SB 3). The May Revision reflects the minimum wage ramp-up, which adds a 50-cent increase on January 1, 2017. The Administration projects annual General Fund costs will be $3.4 billion when the $15 wage is fully implemented, contributing substantially to the projected state deficits in future years.

Budget Continues to Include a Set-Aside for Future Negotiations. The May Revision adjusts the January set-aside to $500 million ($200 million General Fund) to offset potential employee compensation and benefit cost increases that may be finalized in 2016-17. For the first time, the Governor's January budget proposed to set aside $350 million ($300 million General Fund) in 2016-17 for these purposes. 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 transparent government.

Aligning Benefits for Judicial Branch with Civil Service. The May Revision includes a proposal to more closely align the benefit structure of state-level employees in the Judicial Branch with other civil service employees, excluding justices. The employees would receive a 7.5 percent increase in wages over two years, contribute more to their pensions, and participate in recent strategies to address the retiree health care unfunded liability. The proposal makes fiscal sense given the ongoing retirement benefit liabilities and recent contract agreements that include these same provisions for civil service employees.

Statewide Debts and Liabilities

The Governor's May Revision includes nearly $8.3 billion to pay the state's current debts and liabilities, 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. According to the State Treasurer, the state currently has outstanding bonds totaling some $87 billion and has authorization to issue $34 billion more.
- Nearly $1.3 billion to pay a variety of debts and liabilities as mandated by Proposition 2, which was passed by the voters in November 2014. This figure has declined by $264 million from January as the revenue amounts lower the required amount of debt repayment. Most of the difference since January is a delay in special fund loan repayments.
- $1.5 billion to reduce a portion of the state's mandate obligations to K-12 schools and community colleges.

Proposition 2 Liabilities. The Governor's budget identifies $232 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 eligible for repayment from General Fund revenues pursuant to Proposition 2.

Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2 (Governor's 2016-17 May Revision)						
(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*	**1,819**	692	252	392	483	0
Underfunding of Proposition 98 - Settle-Up	**1,232**	218	347	156	1	510
Pre-Proposition 42 Transportation Loans	**879**	173	220	220	266	0
State retirement Liabilities					0	
State Retiree Health	**74,103**	38	150	200	250	N/A
State Employee Pensions	**49,592**	0	0	0	0	N/A
Teachers' Pensions (state portion = 14.916 billion)	**72,626**	0	0	0	0	N/A
Judges' Pensions	**3,279**	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					0	0
Totals	**$232,156**	**$1,292**	**$1,138**	**$968**	**$1,000**	

Total Obligations Approach $330 Billion. 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 GO and LR bonds as well as other debts and obligations. As shown in the following table, adding all of these obligations brings the state's potential total to nearly $330 billion.

Total Statewide Debts and Liabilities (Dollars in Millions)					
	At Start of	Proposed Debt Payments			
	2016-17	2016-17	2017-18	2018-19	2019-20
Debts & Liabilities Identified in Proposition 2	**$232,156**	$1,292	$1,138	$968	$1,000
Long-Term Infrastructure Debts (GO & LR Bonds)	**$87,475**	$5,461	$5,377	$5,571	$5,563
Unemployment Insurance Debt	**$5,500**	$0	$0	$0	$0
Suspended Mandate Debt	**$1,038**	$0	$0	$0	$0
Education Mandate Debts	**$3,331**	$1,522	$0	$0	$0
Totals	**$329,500**	**$8,275**	**$6,515**	**$6,539**	**$6,563**

Unemployment Insurance Loan Debt Repayment. The Governor's May Revision includes $110.7 million General Fund to pay interest costs to the federal government on loans taken out during the Great Recession to pay for unemployment benefits. The Employment Development Department estimates that outstanding debt to the federal government will decrease to about $5.5 billion by the end of 2016, resulting from increased UI taxes on employers imposed by the federal government. The Governor could have chosen to use additional 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, is opposed by various labor groups that seek to increase state UI taxes on employers to support the UI program in the long run.

Statewide Issues and Various Departments

Statewide Infrastructure

Roads for Everyone vs. Sacramento Offices. The Governor's May Revision makes no changes to the January one-time infrastructure proposals, which include $1.5 billion in General Fund to establish pay-as-you-go renovation or replacement of several state buildings in Sacramento. These include the Natural Resources building, the vacant Department of Food and Agriculture Annex, the State Capitol Annex, and several other smaller state-owned buildings. With roads and other infrastructure in dire need of repair around the state, Senate Republicans believe there are higher priorities than buildings in Sacramento. As discussed further on page 27, $754 million in transportation projects is now slated for delay or elimination, and Senate Republicans have called for a portion of the $1.5 billion to be redirected from Sacramento buildings to pay for construction and maintenance of those local projects.

The May Revision also maintains the January proposals for $518 million ($500 million General Fund and $18 million Motor Vehicle Account) for various state departments, to address the state's deferred maintenance needs.

November 2016 Voter Information Guide Costs

The Governor's May Revision adds $10 million to the Secretary of State's office to cover additional printing costs for the potentially sizable Voter Information Guide for the November 2016 General Election. In an April 4, 2016 letter to the Governor, Secretary Padilla requested funding assistance for county elections officials to verify signatures on initiative petitions for the November election, as well as higher printing costs for additional voter information guides. **Senate Republicans continue to stand for election integrity and believe the state should pay local election offices the $77 million owed for past election mandates. Senator Nguyen led an action in Budget Subcommittee #4 to approve funding for that overdue state obligation.**

Earned Income Tax Credit Outreach

The May Revision adds $2 million to the Franchise Tax Board to provide outreach to increase participation in the state's Earned Income Tax Credit, which provides a refundable credit for wage income for households with incomes of less than $6,580 with no dependents or $13,870 if there are three or more dependents. According to the Administration, the program resulted in $255 million in credit usage in 2016 and they project usage to rise to $295 million in 2017. **The creation of this tax credit was spurred on by the introduction of SB 152 by Senator Vidak in 2015.**

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