SENATE REPUBLICANS

Highlights and Analysis of the Governor's May Revision

SENATE REPUBLICAN
FISCAL OFFICE
May 16, 2017

Table of Contents

Executive Summary

Overview: Missed Opportunities. It's no secret that California is becoming increasingly unaffordable for many of its residents, as costs for housing, energy, and gasoline are at or near national highs. Many Californians are not sharing in the current prosperity of those in a few coastal communities like Silicon Valley. Senate Republicans believe that if the state is smart about managing its budget, we can keep moving forward by prioritizing the things that matter to Californians: good schools, safe communities, and a more affordable quality of life in California.

The May Revision misses opportunities through misplaced priorities and too few efforts to make California more affordable, such as by addressing the high cost of housing. The revised budget is largely similar to the Governor's January proposal but reflects somewhat higher tax revenues for 2017-18. The state remains in the unfortunate position of receiving record-high tax revenues but still facing recurring deficits, a result of unrelenting spending growth. The Governor continues to propose $3 billion in budget savings during the current year and budget year combined, including January's "bait and switch" on California voters that redirects Proposition 56 tobacco taxes away from health care to help plug the budget hole.

Spending Growth Creates Deficits. Total General Fund spending would reach a record $124 billion in 2017-18, an increase of $1.7 billion compared to the updated current year amount, even after the Governor's proposed savings items. Although Senate Republicans cautioned against spending beyond our means, billions of dollars in long-term spending commitments made by Sacramento Democrats over the past several years have returned California to a deficit situation in 2016-17. Additionally, annual operating deficits in excess of $1 billion would return by 2019-20 under the Governor's forecast.

Revenues Reach New Record. The May Revision estimates a $2.5 billion increase in General Fund revenue for 2017-18 when compared to the January budget (unrelated to the transportation tax increase). Total General Fund revenue would reach $127.7 billion in 2017-18, a record high that exceeds the revised 2016-17 amount by $6.1 billion and 5 percent. Despite this upward revision, revenues over a three-year period remain lower than assumed when the 2016 Budget Act was signed.

Solutions Package Reduced. The Governor lists $2 billion in spending revisions to address the deficit, compared to a solutions package of $3.2 billion in January. However, the Governor's official list of solutions excludes major savings actions such as the continued "bait and switch" on voters to redirect over $1 billion in Proposition 56 tobacco tax revenues to plug the budget hole, rather than increase access to care through Medi-Cal and Denti-Cal. The May Revision does reverse the January proposal to freeze the child care expansion, but it maintains the reduction to middle-class scholarships, now estimated to be a cut of $32 million in 2017-18, growing to $115 million by 2020-21.

Rainy Day Reserve Likely Not Enough. The Rainy Day Fund (Proposition 2 of 2014) would grow to reach $8.5 billion by the end of 2017-18, or 6.6 percent of General Fund revenue. When combined with the discretionary reserve of $1.6 billion, the total reserve would reach $10.1 billion, or 7.9 percent of General Fund revenue. However, this is insufficient compared to the potential $20 billion shortfall a recession could bring.

Higher Education: Tuition Hikes, Audits, and Budget Choices. In response to recent State Auditor criticism, the May Revision holds $50 million in University of California (UC) funding back until UC acts on the audit recommendations and various other issues. The May Revision also accepts UC and the California State University's recent actions to raise tuition by 2.5 percent and 5 percent respectively.

At the same time, the May Revision creates a double hit to student costs by maintaining the reduction to middle-class scholarships proposed by the Governor in January. The UC should certainly improve transparency and cut waste prior to raising tuition, but it is also the case that Sacramento Democrats have created substantial pressure on UC finances over the past decade by providing only $270 million more General Fund compared to 2007-08, a mere 8 percent increase, while dramatically raising spending by billions of dollars in other areas of the budget.

Proposition 98 Education Sets New Record. Proposition 98 funding for K-14 education would grow by $5.9 billion over three years, up $1.5 billion from January. Revised total Proposition 98 expenditures (including local funds) are $69.1 billion in 2015-16, $71.4 billion in 2016-17, and $74.6 billion in 2017-18. Anticipated sales of K12 school facilities bonds are unchanged from January. The Governor has withdrawn his proposals to "pause" last year's child care expansion for one year and to defer payments worth $859 million from 2016-17 to 2017-18. Unfortunately, the May Revision does nothing to change the previously planned reductions to Career Technical Education funding.

Revised Shift of In-Home Supportive Services (IHSS) Costs. The May Revision reduces the shift of IHSS costs to counties substantially compared to the January proposal, and would leave counties with a net cost of $141 million in 2017-18. However, it remains a cynical strategy for the state to ramp up costs in the program following the beginning of the Coordinated Care Initiative in 2012, then seek to hand the higher cost program back to counties.

Paying Down Pension Debt. The May Revision proposes a loan of $6 billion as a supplemental payment to the California Public Employment Retirement System (CalPERS) to pay down unfunded liabilities. By providing this additional payment now, the state will be able to lower the future estimated employer contributions and potentially save $11 billion over the next 20 years. Repayment of the General Fund share would be credited toward Proposition 2's debt repayment requirements. Senate Republicans have long argued that the state needs to address its unfunded liabilities, but it would be preferable to avoid counting the repayment toward Proposition 2 requirements, which likely means that repayment of other debts could be delayed.

Missed Opportunities for Infrastructure and Environmental Projects. The May Revision recognizes that California's drought is over and removes funds that had been slated in January for drought response. Unfortunately, the budget could have redirected these resources to major needs such as widespread tree mortality and critical flood infrastructure repair needs, but the May Revision largely overlooks these issues.

Significant Transportation Spending Skips Roads. The May Revision includes increased spending of $2.8 billion generated from the new gas, diesel, and vehicle taxes. Of this $2.8 billion, $873 million would be spent on programs that do not fix or maintain California's roads and highways. The extra tax dollars are being spent on other projects such as public transit, walking and biking paths, local planning, state and local park operations and maintenance, and university research programs.

Costs of "Resisting" the Trump Administration Grow. The May Revision proposes $6.5 million General Fund and 19 positions for the Attorney General to continue his ongoing efforts to derail the federal government. The proposed funding would primarily support legal staff who would contest the constitutionality of executive actions related to immigration, healthcare, and the environment. While it is admirable that the Attorney General and the Governor have suddenly gained an appreciation for states' rights, Senate Republicans believe that the state should work with the federal government to maximize value for Californians, rather than "poking the bear" for political points.

Revenues, Expenditures, Deficits, and Reserves

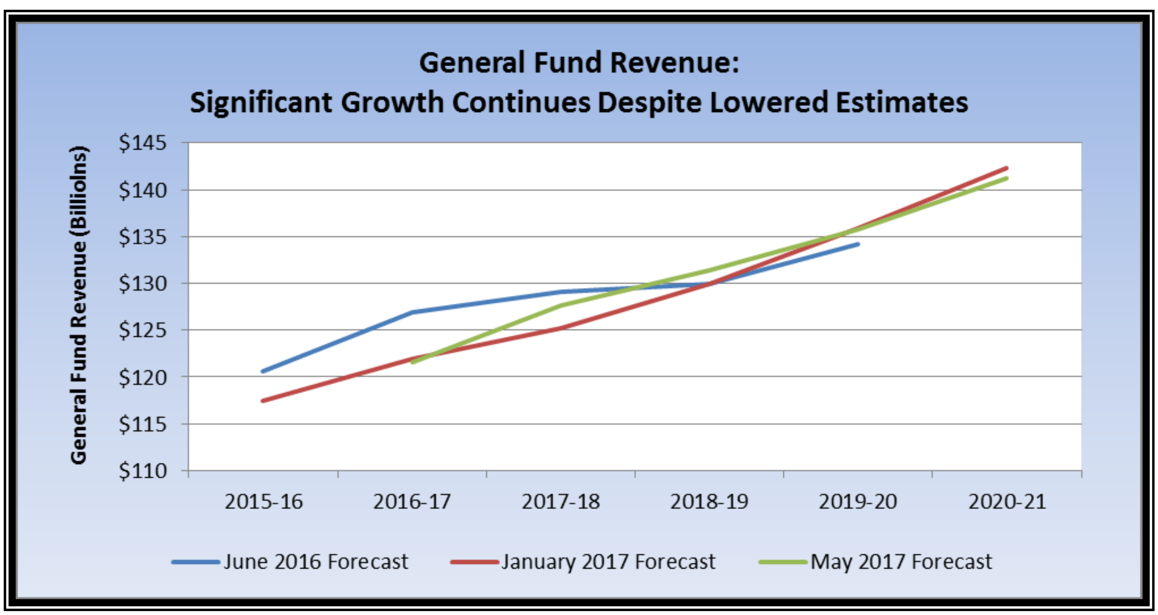
Key Points

- **Record Revenues Can't Keep Up With Rapid Spending.** Despite record-high revenue, California's unrelenting spending growth means that the state has an operating deficit in 2016-17 and will see annual deficits in 2019-20 and 2020-21.
- **Spending Reductions Should Be Better Targeted.** While spending adjustments are necessary, Californians could maintain priorities like college scholarships and career technical education, as well as improve care for kids in Denti-Cal, if spending were better prioritized.
- **Reserves Likely Insufficient.** The Rainy Day Fund reserve would grow to $8.5 billion under the Governor's proposal, but at only 6.6 percent of revenue, this would provide scant protection from even a mild recession, which could lower revenue by $20 billion.

Revenues Continue to Set Record Highs

Revenues Would Reach New Record High. The May Revision projects total General Fund revenues and transfers of $121.6 billion in 2016-17, increasing to $127.7 billion in 2017-18, an increase of $6.1 billion (5 percent) to a new record high. Compared to January 2017, these estimates are lower by $396 million in 2016-17 but higher by about $2.5 billion in 2017-18. The most significant change is an increase of $3 billion in the Personal Income Tax, largely attributed to capital gains associated with the strong stock market performance since January. This gain is offset somewhat by a drop of over $700 million in sales tax revenue.

The chart below shows the shifts in estimates since the 2016 Budget Act forecast. The revised revenue estimates represent a cumulative decrease of $3.3 billion since then, but despite this softening outlook, significant annual increases are still projected through 2020-21. These revenues include over $7 billion annually from Proposition 30 (2012) tax increases, which will continue past 2018 as a result of Proposition 55 (2016). The steady revenue growth makes it clear the state does not have a revenue problem.



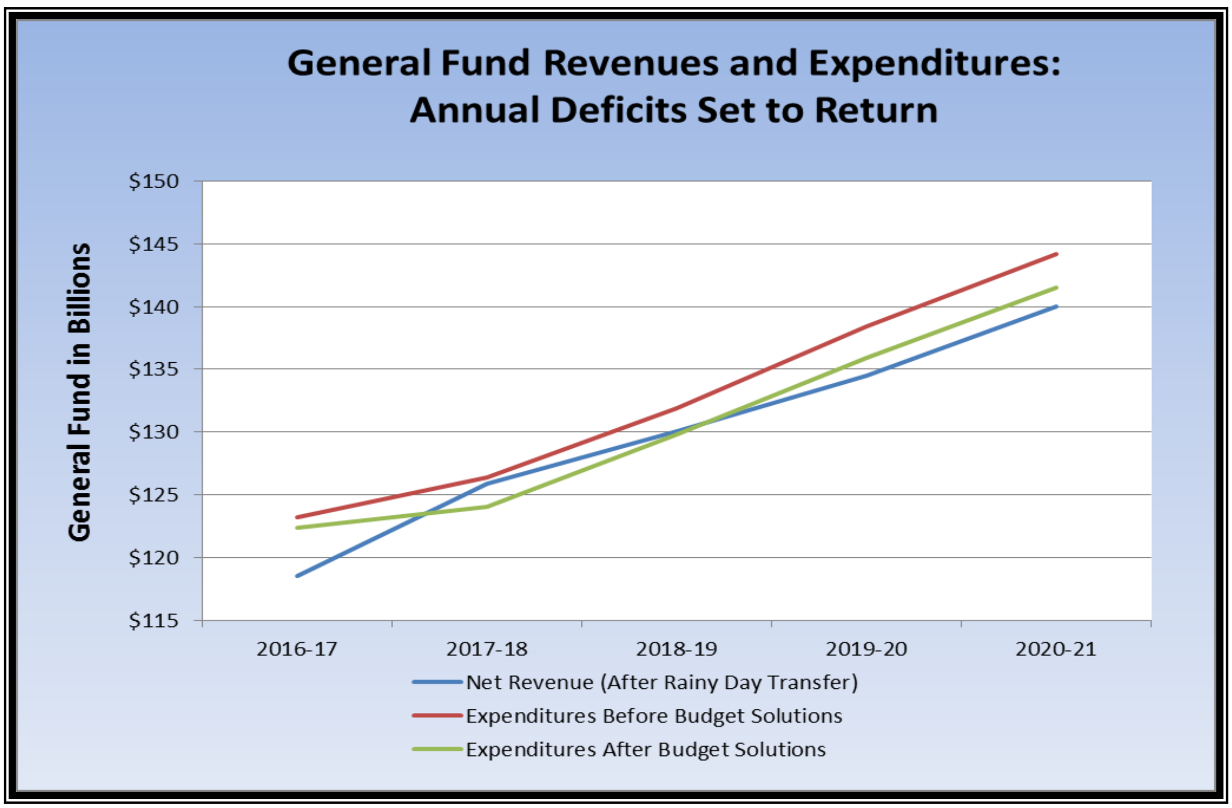
The Legislative Analyst's Office projects revenues that are similar to the Governor's estimates: $970 million more revenue than the Governor's projection for 2016-17, a difference of less than

1 percent, and nearly identical forecasts for 2017-18. This is a notable change from previous budgets, when the Analyst's projections were several billion higher than the Governor's estimates.

Fast-Growing Expenditures Gobble Up Record Revenue

Budget Deficits Return Despite Record Revenues. Total General Fund spending would reach a record $124 billion in 2017-18, an increase of $1.7 billion compared to the updated current year amount, even after the Governor's savings proposals. Billions of dollars in long-term spending commitments made by Sacramento Democrats over the past several years have returned California to an operating deficit of more than $2 billion in 2016-17, even after accounting for General Fund solutions. (Discretionary reserves from prior years allow the state to avoid even more budget cuts.)

Annual Deficits Around the Corner. Following massive spending increases enacted by Sacramento Democrats, annual operating deficits in excess of $1 billion are set to return in 2019-20 and 2020-21 under the Governor's forecast. Operating deficits show an ongoing, structural budget problem since each year's revenues do not pay for that year's expenses—the state must use reserves to cover the extra costs. As seen in the chart below, a short-lived surplus in 2017-18 is replaced by deficits by 2019-20. (Deficits are seen in years when the green expenditures line exceeds the blue revenue line.)



Overall Spending Rises Significantly Despite General Fund Reductions. While the General Fund typically dominates budget discussions, federal and other funds play a much more significant role today than in past decades. As shown in the table on the next page, the General Fund now accounts for only about 43 percent of total spending. Each category of funds would grow under the May Revision, including a 20 percent increase for Special & Bond funds, which is partly driven by nearly $3 billion in transportation tax spending. Total spending from all sources would increase in 2017-18 by $23 billion (nearly 9 percent) to $290 billion, relative to the 2016 Budget Act.

Expenditures by Fund Type
Dollars in Billions

	Budget Act 2016-17	% of Total	May Rev. 2016-17	% of Total	May Rev. 2017-18	% of Total
General Fund	$ 122.5	46%	$ 122.3	45%	$ 124.0	43%
Special & Bond Funds	48.4	18%	53.0	20%	59.4	20%
Federal Funds	95.9	36%	96.2	35%	106.8	37%
Total	**$ 266.8**	**100%**	**$ 271.5**	**100%**	**$ 290.3**	**100%**
Total Increase from 2016-17 Budget Act			**2%**		**9%**	

Significant increases in special funds are the result of ballot measures or tax increases. The recently enacted gas and car tax (SB 1, Beall, 2017) will add $2.8 billion in special fund spending in 2017-18. Spending related to the hospital quality assurance fee, which Proposition 52 extends, is budgeted to rise by over $1 billion in 2016-17 compared to the enacted budget, and Proposition 56 tobacco taxes will increase special fund spending by about $1.7 billion in 2017-18.

<u>Addressing the Deficit</u>

Spending Reductions Adjusted. The May Revision reduces the proposed package of General Fund budget solutions from $3.2 billion in January to just over $2 billion. The vast majority of this change is a formula adjustment of roughly $1 billion in Proposition 98 education spending that results from the larger revenue estimate. However, the Governor also rescinds a January proposal to “freeze” an expansion of child care, as discussed further on page 12. A full list of the Governor’s proposals is shown in the Appendix on page 32.

Tobacco Tax Bait-and Switch Continues. The “official” list of budget solutions excludes a nearly $1.3 billion cost shift from Medi-Cal General Fund to Proposition 56 tobacco taxes, which should be counted as a budget solution. The May Revision continues this bait-and-switch on California voters, who supported Proposition 56 with the expectation that the funds would help increase access to health and dental benefits through Medi-Cal. Republicans have proposed to use the tobacco taxes to meet voter expectations and improve the Denti-Cal program through legislation (Assembly Bill 15, Maienschein).

Spending Reductions Should Be Better Targeted. Unfortunately, the Governor maintains the January proposal to phase out middle class college scholarships, and a previously scheduled decline in career technical education funding of $100 million would continue. (These are discussed in more detail on pages 11-16). ***Reductions to programs like middle class scholarships and career technical education could be avoided if budget adjustments were targeted at other, faster growing areas of state spending that should be lower priorities.*** For example, the May Revision reflects over $600 million General Fund for employee pay raises and benefits, the latest in a string of recent increases. Simply avoiding some of these planned increases – without actually reducing compensation – could allow the state to maintain its middle class scholarship program and avoid the reduction to career technical education.

Low Reserves Could Mean More Cuts to Needed Programs

Reserves Still Insufficient to Offset Recession. The risk of low reserves is that when the good times end, the state will have to reach out and take back services that it may have just begun or expanded. The large swings in tax revenues that are typical in California mean that healthy reserves are all the more important to avoid major reductions to important programs. The Department of Finance estimates the General Fund shortfall could reach $20 billion, or 15.7 percent of revenue, in one year of a moderate recession.

Rainy Day Fund (RDF) Would Grow, Though Still Inadequate. Proposition 2 (2012) established a constitutional reserve target of 10 percent for the RDF. For 2017-18, the Governor proposes to make the minimum required deposit of about $1.8 billion to the RDF, which would bring the balance to $8.5 billion, or 6.6 percent of General Fund revenue. This is a slight improvement over the reserve level expected in January of 6.3 percent of revenue. However, even with strong revenue growth, the May Revision estimates that the RDF would only reach 8.8 percent of revenue by 2020-21.

In addition to the RDF, the May Revision proposes to finish 2017-18 with an unrestricted reserve of nearly $1.6 billion General Fund. Combined with the RDF, the total reserve would reach $10.1 billion, or 7.9 percent of General Fund revenue. This offers little protection compared to the potential revenue downturns.

Also, Proposition 2 limits the withdrawal from the RDF to half the balance available in the first year the funds are needed (in order to avoid using the entire balance in one year). This means only about $4.2 billion of the RDF would be available in the first year to offset the effects of a moderate recession. This magnifies the importance of building the reserve to a higher level.

Extra Deposit Diminished. In the 2016-17 budget, the Governor sought and obtained legislative approval to make an extra $2 billion deposit into the RDF. The May Revision reflects a significant reduction to that extra deposit, which would now be only $1.5 billion in 2016-17. This is because the $2 billion deposit was enacted with a caveat in the 2016 Budget Act (not Proposition 2 itself) requiring that any positive "true-up" adjustments made to the RDF deposits in subsequent years would be netted out of the $2 billion. Given how low the reserve remains, it would be prudent to amend that requirement and contribute the entire $2 billion to the reserve.

Federal Fund Risk Remains. California's budget relies heavily on federal funds, including over $68 billion for Medi-Cal and related health programs. It is unlikely that the version of the American Health Care Act passed by the House of Representatives will be ultimately signed into law, but if it were, the General Fund impact would be $3.3 billion in 2020 and $13 billion by 2027. This uncertainty highlights the need for a more robust reserve in order to avoid significant cuts to needed state programs.

Health & Human Services

Key Points

- **County Cost Shift Reduced.** The May Revision reduces the shift of costs to counties for the In-Home Supportive Services (IHSS) Program, but it remains a highly cynical strategy for the state to ramp up IHSS program costs and then pass the buck back to counties.
- **Tobacco Tax Bait-and-Switch Continues.** The May Revision continues to transgress voter intent by using tobacco taxes to plug budget holes instead of expanding access to dental and health care.
- **Using Taxpayer Money for the "Resistance."** The Governor expands the state's role in deportation proceedings.

Cynical Cost Shift to Counties Continues, Though at Lower Level. Since January the counties have been sounding the alarm that the Governor's proposal to saddle them with $623 million in IHSS costs could result in dramatic cuts to county-provided services. After negotiating with the counties, the Governor's May Revision proposes several changes expected to lower the cost to counties from $623 million to $141 million in 2017-18 with costs ranging from $129 million to $251 million in the following years.

The reduction to the county cost shift is a significant improvement from January, though the dramatic cost increases to IHSS over the past five years were predictable effects of state and federal policy changes. It remains a cynical strategy for the state to ramp up IHSS program costs and then pass the buck to counties.

Specifically, the May Revision proposes the following IHSS changes to mitigate county costs:

- Revises the estimate of the total program cost in 2017-18 from $623 million to $592 million.
- Contributes General Fund at declining levels to offset counties' additional costs: $400 million in 2017-18, $330 million in 2018-19, $200 million in 2019-20, and $150 million in subsequent years.
- Reprioritizes local Vehicle License Fee (VLF) funds given to the counties through realignment. Specifically, the plan redirects the VLF growth from the county health and mental health subaccounts to fund the IHSS program costs. It is unclear what other local services could be affected by this shift. It is possible that additional county funds may be necessary to support these other programs.
- Modifies the county maintenance-of-effort (MOE) to make counties responsible for a sliding share of non-federal IHSS costs. Specifically, the proposal sets a new baseline obligation on the counties but caps the counties' growth of this obligation based on realignment revenue collections each year. Better revenue years would mean greater county share of IHSS program costs, while bad revenue years would result in the state covering all of the IHSS program growth costs.
- Authorizes counties to access a new low-interest loan program to help counties pay for their share. Details on this program are still in discussions.
- Continues the January proposal to return IHSS collective bargaining to counties, but proposes that the state participation cap on wage increases rises to the level of $1.10 above the hourly minimum wage set in SB 3 (Leno, 2016) for large employers. The cap would continue to rise with inflation once the minimum wage reaches $15 per hour. For counties at or exceeding the

current state cap of $12.10, the state would agree to participate at its 65 percent share of costs up to a 10 percent increase in wages and benefits over three years. This means that the state must pay for the impact of SB 3's minimum wage increases but stops its cost participation if union bargaining agreements go beyond the 10 percent.

- Requires mediation at Public Employment Relations Board if there is a county/union impasse after nine months. While this gives the counties an incentive to negotiate within the timeframe, it could result in unions delaying agreements if they feel that mediation would improve their position.

Continues Tobacco Tax Bait-and Switch. Despite recent negotiations with stakeholders, the May Revision plans to use $1.3 billion in Proposition 56 tobacco taxes to backfill General Fund expenditures in Medi-Cal, thus plugging a budget hole instead of increasing access to care. Advocates contend that this is a misuse of the funds and that voters rightfully expect the revenues to attract and retain Medi-Cal and Denti-Cal providers.

Using Taxpayer Money for the Anti-Trump Resistance. The May Revision includes an increase of $15 million General Fund to fund an expanded immigrant services program at the Department of Social Services. These funds are to be awarded to non-profit organizations for services such as naturalization, immigrant education and outreach, and deportation defense. The Administration is proposing trailer bill language similar to SB 6 (Hueso, 2017) to implement this expansion of services. As with SB 6, there should be concern that these funds are not used to protect undocumented individuals with troubling criminal records.

Retains Health and Human Services Cuts. The May Revision continues several of the January budget's proposed General Fund cuts to Health and Human Services, including a $100 million cut for primary care residency funding, a $67.5 million cut for local mental health and substance use disorder grants, a $17 million cut for children's mental health grants, and a $705,000 cut to three Central Valley Independent Living Centers. Reductions to important programs like these could be easily avoided if the state prioritized its spending better. For example, continued annual increases to state workers add hundreds of millions in General Fund spending to the budget each year that could be better spent on kids' mental health.

Upgrade of Medi-Cal Estimate System to Reduce Errors. The May Revision requests one-time contract funding to its Medi-Cal Budget Estimate system to provide estimates that are more accurate, with increased transparency and reporting capabilities. In January, the administration admitted to a $1.8 billion error in the 2016-17 Medi-Cal estimate. Fortunately, this error has been reduced to $1.2 billion in the Governor's May Revision due to slower caseload growth and drug rebate savings.

Elimination of the Newly Qualified Immigrants Program. Existing law authorizes the Department of Health Care Services to implement a program to transition immigrants under state-only funded full-scope Medi-Cal to a Covered California health plan and have all of their out-of-pocket costs covered by the state. This was sold as a way to reduce Medi-Cal costs, but due to operational and programmatic uncertainties (how to integrate this program into health plan rate structures) the Department will stop efforts to implement this program. This results in $48 million in new General Fund costs.

Drug Discounts for Hospitals and Community Centers at Risk. The administration is proposing trailer bill language to no longer permit the use of contract pharmacies in the 340B Drug Billing program for Medi-Cal. In the 340B program, covered entities like hospitals and community clinics purchase discounted drugs from manufacturers enrolled in the program. The administration is concerned that these covered entities are contracting with non-340B pharmacies to purchase drugs and then bill Medi-Cal to cover the difference in cost. This proposal is of concern to hospitals and community centers as an increase in drug costs could put many of their specialty care programs at risk of closure.

New Federal Funds for Opioid Epidemic. The May Revision includes an increase of $44.7 million in federal funding to reflect the award of the federal Opioid State Targeted Response grant. The funding will be directed to participating physicians for increased medication assisted treatment for individuals with substance use disorders. The administration is proposing trailer bill language in order to expedite these funds.

Food Bank Funding. The Department of Social Service's CalFood program will get $2 million in one-time General Fund to help purchase food from California's agricultural producers for distribution to food banks throughout the state. This program is particularly important to residents in those areas of California that are often ignored by liberal Democrats.

Education

Key Points

- **Proposition 98 Gets Lion's Share of General Fund Revenue Growth.** The Proposition 98 guarantee of funding for K-14 education takes $2.2 billion of the May Revision's additional $2.4 billion in projected General Fund revenue growth.
- **Career Technical Education Phase-Out Continues**. Support for Career Technical Education falls by $100 million, leaving high school graduates less prepared to join the workforce.
- **Child Care Expansion Proceeds.** Last year's multi-year child care expansion proceeds with a $239 million augmentation.

Education funding continues to grow. The chart below displays proposed 2017-18 Proposition 98 funding for K-14 education, based on the Governor's May Revision revenue estimates. Proposition 98 education funding would reach an all-time high of $74.6 billion in 2017-18 ($1.1 billion above the January budget proposal), average per pupil K-12 spending would reach $11,080,[1] and the Proposition 98 maintenance factor obligation would stand at $823 million by the end of the fiscal year.[2] The Governor has withdrawn his January proposal for an $859 million expenditure deferral from 2016-17 to 2017-18 and replaced it with a plan intended to generate similar savings through 2020-21.

Proposition 98 Funding at 2017-18 May Revision

Source: Legislative Analyst's Office

($ in millions)	2015-16 at 2016-17 FBA [2/]	2015-16 at 2017-18 GB [3/]	2015-16 at 2017-18 MR	Change From GB	2016-17 at 2016-17 FBA	2016-17 at 2017-18 GB	2016-17 at 2017-18 MR	Change From GB	2017-18 at 2017-18 GB	2017-18 at 2017-18 MR	Change From GB
K-12 education [1/]											
General Fund	$44,225	$43,604	$43,957	$354	$45,440	$44,804	$45,029	$225	$45,806	$47,097	$1,291
Local property tax revenue	$16,759	$17,052	$17,048	-$4	$18,057	$18,236	$18,035	-$201	$19,200	$18,858	-$343
K-12 subtotal	$60,984	$60,655	$61,005	$350	$63,496	$63,039	$63,063	$24	$65,006	$65,954	$948
California Community Colleges [4/]											
General Fund	$5,415	$5,304	$5,384	$81	$5,528	$5,443	$5,489	$46	$5,465	$5,674	$209
Local property tax revenue	$2,569	$2,630	$2,631	$2	$2,767	$2,803	$2,753	-$50	$2,959	$2,891	-$68
CCC subtotal	$7,983	$7,933	$8,016	$83	$8,295	$8,246	$8,242	-$4	$8,424	$8,565	$141
Other Agencies	$82	$82	$82	$0	$83	$83	$85	$2	$80	$81	$1
Total Proposition 98 [5/]	$69,050	$68,671	$69,103	$433	$71,874	$71,368	$71,390	$22	$73,511	$74,601	$1,090
General Fund	$49,722	$48,989	$49,424	$435	$51,050	$50,330	$50,602	$273	$51,351	$52,852	$1,500
Local property tax revenue	$19,328	$19,681	$19,679	-$2	$20,824	$21,038	$20,787	-$251	$22,160	$21,749	-$411

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

Local Control Funding Formula (LCFF) grows to 97% of target level. The state's local control funding formula for K-12 schools will enter its fifth year of implementation in 2017-18. The May Revision increases locally-controlled funding by $1.4 billion (up from $744 million in January), to about $57.3 billion, or 97% of the statewide target level of $59 billion.[3] The Department of Finance continues

[1] Per-pupil spending varies widely across the state under the Local Control Funding Formula, which provides substantially more funding to districts with high proportions of low-income students; $11,080 is an estimate of *average* per-pupil spending.
[2] 2017-18 is expected to be a Test 2 year, meaning that the operative funding formula grows the previous year's funding level grows by the same rate that the state's per-capita personal income and student attendance are expected to grow. The maintenance factor obligation is the amount by which Proposition 98 funding must eventually be increased to bring it to the long-term Test 2 level.
[3] LCFF targets grow annually by a cost-of-living adjustment (currently 1.56%, up from 1.48 percent in January).

to expect that full funding will be reached by 2020-21. Senate Republicans have supported full funding of the LCFF based on its enhancement of local control.

One-time discretionary funds to flow in May 2019. In addition to its ongoing LCFF augmentation, the May Revision includes about $1 billion in one-time funding for any local educational priority, up from $287 million in January. In an effort to avoid permanently inflating the Proposition 98 guarantee beyond the level required by law, release of these funds would be postponed until May 2019 and restricted to the amount needed to meet the spending level required by the final 2017-18 Proposition 98 guarantee (which will not be known until well after the fiscal year ends). The funds would be allocated on a per-student basis and scored in satisfaction of outstanding mandate claims by recipients who have filed such claims, thereby reducing the state's $2 billion mandate debt by several hundred million dollars (not all districts have unpaid mandate claims). This effort to maintain maximum budgetary flexibility while reducing the state's mandate debt is consistent with the Senate Republican priority of respecting the voters through responsible government.

Career technical education (CTE) funding continues to fall. 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 ($400 million in year one, $300 million in year two, $200 million in year three, and nothing thereafter). The May Revision maintains the Governor's January proposal to allow funding to continue falling, from the current $300 million to $200 million in 2017-18. Senate Republicans have urged the restoration of ongoing funding for career technical education, which is essential to ensure that students who wish to join the workforce leave high school with the skills to do so.

Multi-year child care expansion restored. The Governor's January budget proposed a "pause" in the multi-year child care expansion negotiated as part of the 2016 Budget Act, which was intended to increase child care and state preschool funding by $128 million in 2016-17, growing to $527 million by 2019-20. The May Revision rescinds the pause and provides $239 million to continue the multi-year expansion as planned.[4]

California Community Colleges (CCCs). The May Revision increases the CCCs' share of 2017-18 Proposition 98 funding by $141 million beyond the January level, to $8.6 billion.[5] The additional funds, along with $22 million freed up by a lower estimate of enrollment growth, would be used to provide a higher unallocated base funding increase and funding for deferred maintenance. The most notable May Revision adjustments to the colleges' budget include:

- $160 million for an unallocated base funding increase (to $184 million, up from $24 million in January)
- $136 million for deferred maintenance and instructional equipment (up from $44 million in January), including $124 million that would be released in May 2019 and restricted to the amount needed to meet the spending level required by the final 2017-18 Proposition 98 guarantee (which will not be known until well after the 2017-18 fiscal year ends).[6]
- $58 million for one percent enrollment growth (down $21 million from $79 million in January for 1.34 percent growth)

[4] Specifically: 1) $68 million to continue a five percent increase in the standard reimbursement rate (SRR) for classroom-based care that began in 2016-17 (originally intended as a ten percent half-year increase but implemented by the Department of Education as a five percent full-year increase); 2) $93 million to increase the SRR by an additional six percent effective July 1, 2017, 3) $42 million to increase regional market rates for voucher-based care to the 75th percentile of the 2016 regional market rate survey, effective January 1, 2018, 4) $29 million to provide a cost-of-living adjustment for non-CalWORKS child care and preschool programs, and 5) $8 million to add 2,959 full-day state preschool slots at local educational agencies effective April 1, 2018.
[5] CCC funding includes $500 million for adult education, which can flow to any K-14 education agency.
[6] To balance one-time and ongoing fund sources, the May Revision would shift $86 million in one-time funds from this program to the Guided Pathways Program, and the same amount of ongoing funds from Guided Pathways into this program.

- $4 million for a 1.58 percent cost-of-living adjustment to apportionment funding and selected categorical programs ($102 million, up from $98 million for a 1.48 percent COLA in January)
- $11.7 million in Proposition 51 bond funds to begin nine capital outlay projects (four of which were added in an April 2017 Finance Letter)

UC, CSU, and Student Financial Aid

Key Points

- **University of California (UC) Tuition Rises**. The May Revision recognizes UC's tuition hike despite its hidden budget reserves. A decade of low General Fund support for the UC has contributed to financial pressure.
- **Middle Class Scholarship Cut Continues.** The May Revision continues the ill-advised proposal from January to phase out middle class scholarships, despite higher overall state revenues.
- **Bait and Switch Continues for Medical Education**. Proposition 56 tobacco tax funding replaces existing funding for medical education, as in January, rather than increasing it as the voters expected.

As the chart below shows, the May Revision generally maintains the Governor's January approach for the UC and California State University (CSU) budgets.

UC & CSU Funding per Governor's 2017-18 May Revision

Core funds, in millions

	Fund	2015-16 January	2015-16 May	2016-17 January	2016-17 May	2017-18 January	2017-18 May	change Jan to May
UC	General Fund [1/]	$3,259	$3,259	$3,541	$3,541	$3,531	$3,527	($4)
	Tuition and Fees [2/]	$4,087	$4,087	$4,393	$4,393	$4,548	$4,623	$74
	Other UC Core Funds [3/]	$318	$318	$309	$309	$310	$310	$0
	Lottery	$38	$38	$36	$36	$36	$36	$0
	Total UC Instructional Funding [4/]	$7,703	$7,703	$8,279	$8,279	$8,426	$8,496	$70
CSU	General Fund [1,5/]	$3,276	$3,276	$3,589	$3,589	$3,715	$3,700	-$15
	Tuition and Fees [2/]	$3,022	$3,022	$2,963	$2,963	$2,963	$3,098	$135
	Lottery	$58	$58	$55	$55	$55	$55	$0
	Total CSU Instructional Funding	$6,357	$6,357	$6,607	$6,607	$6,733	$6,854	$121

1/ Includes general obligation bond debt service.
2/ Includes systemwide resident and nonresident tuition and fees, before discounts and waivers.
3/ Includes application fees, interest, and a portion of grant overhead and patent royalty income.
4/ UC's budget includes other funding (e.g., federal research grants, medical center revenue, etc.)
5/ Includes funding for CSU retired annuitant health care costs from another budget item.

Source: Legislative Analyst's Office

University of California (UC) Tuition Increase Follows Years of Stagnant State Support. The May Revision recognizes the $74 million in tuition fee revenue generated by a 2.5 percent tuition increase recently approved by UC, which takes effect in fall 2017. UC plans to divert $26 million of this revenue to student financial aid, leaving $48 million available for other uses. UC tuition will rise from $11,220 to $11,502 per year (a separate student services fee increase was built into the January budget proposal).

The recent UC audit report prompted bipartisan calls for UC to rescind its tuition increase, and there is little doubt that UC should cut bureaucracy and waste prior to raising tuition. **However, over the past decade of largely Democrat management of the state budget, General Fund support for UC has barely increased.** The May Revision provides General Fund support for UC at roughly $3.5 billion, which is only about $270 million (eight percent) above the amount provided in 2007-08, the last "good" year before the recession). In contrast, the state has provided over $2 billion in pay increases to state workers over the same period. UC's *total* instructional funding has increased by over $2.9 billion since 2007-08, largely due to tuition hikes in 2008-09 through 2011-12, but if Democrats made UC a higher priority for the General Fund, there would be substantially less pressure for tuition increases that make it harder for middle class students to afford college.

Aside from its 2017-18 funding adjustments, the May Revision signals the Governor's intention to reduce the recent four-percent annual increases in General Fund support for UC to three percent.

- **Penalty for UC Audit Findings.** The Governor proposes to withhold $50 million in General Fund support until UC addresses some of the recommendations made in a recent state audit[7] and demonstrates compliance with the terms of its 2015 budget agreement with the Governor (increasing its admission of transfer students and completing two activity-based costing pilot programs). This withholding is a supportable effort to motivate more responsible behavior by UC management. Senate Republicans have expressed serious concerns with the State Auditor's findings that the UC Office of the President maintained a $175 million fund out of sight of the UC Regents and the public, overcompensated its staff, and spent lavishly on parties, dinners, and travel. Given the Auditor's findings, UC should consider rescinding its tuition hike and operating within existing resources.
- **Bait and Switch for UC Medical Education**. The May Revision continues to include a fund swap that uses $50 million in new Proposition 56 tobacco tax revenue for medical education, in place of existing General Fund, unchanged from January. Senate Republicans have expressed concern that this fund swap is an affront to the voters, who intended to increase funding for medical education in California.

California State University (CSU) Tuition Rises. Similar to its approach for UC, the May Revision largely maintains the Governor's January General Fund support of CSU at roughly $3.7 billion, or about $729 million above the amount provided in the last "good" year before the recession. CSU's *total* funding has increased by almost $2.4 billion since 2007-08, largely due to tuition hikes in 2008-09 through 2011-12. The most notable May Revision adjustments to the CSU budget include:

- A $135 million increase in fee revenue generated by a recent five percent tuition increase (from $5,472 to $5,742) and a non-resident supplemental tuition increase, both effective in fall 2017. Of the $119 million generated by the five percent increase, CSU plans to divert about $40 million to student financial aid, leaving about $79 million available for other uses.
- A $127 million unallocated base funding increase, down $4 million from January. The Governor proposes to redirect this $4 million and a like amount from UC to cover the increasing cost of Cal Grants.
- An $11 million reduction in funding for CSU pension costs, reflecting recently-revised state contribution rates (unlike UC which has its own pension system, CSU participates in the state's pension system).

Similar to his approach for UC, the May Revision signals the Governor's intention to reduce the recent four-percent annual increases in General Fund support for CSU to three percent, starting in 2018-19.

Student financial aid grows to cover higher tuition. The May Revision provides a net increase in the Student Aid Commission's budget for grants, student loan assumption programs, and outreach activities of $111 million, to over $2.2 billion.

- **Cal Grant Funding Grows; Hit to Private Cal Grant Awards Rescinded.** The May Revision provides a $123 million augmentation for Cal Grants (compared with flat funding in January),

[7] The University of California Office of the President: It Failed to Disclose Millions in Surplus Funds, and Its Budget Practices are Misleading: https://www.bsa.ca.gov/pdfs/reports/2016-130.pdf

including $49 million to offset the higher cost of UC and CSU tuition and $8 million to maintain the current maximum Cal Grant for students attending private, non-profit universities (such as Stanford, USC, or Pepperdine) at $9,084 rather than letting it fall to $8,056 as current law requires. Senate Republicans support the withdrawal of the pending reduction, as private non-profit universities provide excellent value to the taxpayer by relieving pressure on UC and CSU campuses that have no room to grow.

- **Middle Class Scholarships Still Take Hit**. The May Revision continues an unfortunate January proposal to phase out the Middle Class Scholarship Program. This would result in a General Fund cut of $32 million in 2017-18, which would increase to $115 million by 2020-21 as existing scholarships gradually end. In addition to this policy shift, the May Revision would reduce funding for the program by $10 million beyond the January reduction (to $64 million, compared with $74 million in January) to reflect revised estimates of current participation. No new awards would be made. Senate Republicans are concerned that phasing out these scholarships could harm deserving students. This is one of the few state programs established to benefit the middle class. It could be maintained by targeting necessary reductions at other fast-growing programs that should be lower priorities.

Public Safety and Judiciary

Key Points

- **Data on Sentence Reform Still Lacking.** The Department of Corrections and Rehabilitation (CDCR) recently published emergency regulations to implement the criminal justice reforms of Proposition 57 (2016), but the May Revision fails to include adequate resources to assess the initiative's impacts on public safety.
- **Underfunded Courts Make Justice Harder to Find.** The most recent estimates from the Judicial Council indicate a gap of about $300 million between budgeted resources and the workload needs of the trial courts.
- **Taxpayers to Pay More for Attorney General's Political Saber Rattling.** Despite the fact that the election was over six months ago, the May Revision includes $13 million for the Attorney General to continue his political assault on federal policy for the next two years.

Department of Corrections and Rehabilitation

The May Revision proposes 2017-18 General Fund spending for CDCR of $11.1 billion, which is up by about $100 million from the level proposed in January. Major components of this increase include roughly $70 million in employee compensation changes due to the timing of collective bargaining agreements and $35 million for roof repairs at several prisons due to the extraordinarily wet winter, offset by savings from reduced juvenile and adult institutional populations. The adult parolee population is projected to increase slightly relative to January estimates. These population changes are mostly the result of CDCR's accelerated Proposition 57 implementation plan (see below).

Proposition 57 Sentence Reforms Accelerated. Proposition 57 (2016) made changes to the state's criminal justice system that impact both juvenile and adult felon populations, including those in custody and those on parole. Specifically, the initiative limited the amount of time an inmate must serve before being eligible for parole, granted CDCR broad authority to increase sentence credits, and eliminated direct filing of juvenile cases involving serious and/or violent felonies in adult court.

The Governor's January budget reflected net savings in 2017-18 of $22.4 million, due mostly to a projected decrease in the average daily prison population of 1,959 inmates. This projection assumed the parole and sentence credit changes would go into effect in October 2017. On April 13, the Office of Administrative Law approved CDCR's emergency regulations for the implementation of Proposition 57, paving the way for the sentence credit changes to take effect on May 1 and for the parole changes to begin July 1. This accelerated timeline results in an additional budget year decrease in the adult prison population of about 700 inmates, which is expected to generate savings of $16 million above January estimates.

As these changes are rolled out, it will be vital to carefully monitor the public safety impacts. Unfortunately, the Governor's implementation plan lacks a robust data collection component and will likely leave many questions about Proposition 57's effects unanswered. As final regulations work their way through the administrative process, Senate Republicans believe they should reflect lessons learned from the observed effects of the emergency regulations on public safety. More needs to be done to ensure the right data is collected to enable accurate assessment of these major changes to California's criminal justice system.

Welcome Efforts to Reduce Drug Use in Prison Intensify. Following a three-year pilot project aimed at reducing the amount of drugs and other contraband entering our state's prisons, the May Revision includes a request for $6.7 million General Fund to continue funding a portion of the program on a statewide basis. The pilot provided a combination of canine contraband search teams, corrections staff, ion scanners, and surveillance technology to 11 prisons, three of which received greater concentrations of these resources for more intensive interdiction efforts. CDCR contracted with UC Berkeley and the Public Policy Institute of California to evaluate the pilot. The evaluation found that drug use was significantly reduced at the three institutions with more intensive interdiction programs, although findings regarding which elements of the program were most effective were inconclusive.[8] The Governor's proposal would expand the canine contraband search teams to provide two permanent teams at each institution.

Substance abuse and contraband trafficking within our prisons contribute to prison politics, lead to increased violence, jeopardize the safety of inmates, staff, and volunteers, and undermine rehabilitative efforts. These negative impacts ultimately result in the perpetuation of criminal behavior when inmates are released into our communities. To successfully reduce these illicit activities, CDCR will need to focus on both supply (through interdiction efforts) and demand (via substance abuse treatment and other rehabilitative programs). In recent years, much attention and funding have been directed to treatment and rehabilitation, but aside from CDCR's pilot project, little has been done with respect to interdiction. Senate Republicans believe that although we do not know definitively whether the pilot interdiction program represented the most cost-effective mix of interdiction strategies or whether increasing just the canine teams as the May Revision proposes might be equally as effective, the bottom line is that we have to start somewhere. The Governor's approach is a reasonable plan to step up interdiction efforts and reduce drug use system-wide.

Judicial Branch

The May Revision provides $3.6 billion ($1.7 billion General Fund) to support the Judicial Branch, including approximately $2.8 billion ($1.3 billion General Fund) for the trial courts. This remains virtually unchanged from the proposed spending levels in January.

Trial Courts Remain Underfunded. As was the case with the Governor's January budget proposal, the May Revision fails to provide any significant increase in funding for trial court operations. The Judicial Council conducts regular assessments of judicial needs and trial court workload. These assessments have shown a consistent underfunding of the trial courts for the last decade. Although some progress has been made in recent years toward closing the gap, the trial courts remain underfunded by about $300 million. As the Chief Justice stated earlier this year in her State of the Judiciary address, "chronic underfunding of the courts is just one way a justice system can become unjust…to keep our checks and balances intact, we need resources to provide justice to the people who need it." Senate Republicans believe that funding a healthy judiciary is necessary to keep our promise to protect the rights of the most vulnerable Californians. Additional funds will be necessary for the trial courts to fulfill their role in keeping our communities safe.

Department of Justice (DOJ)

Costs of "Resisting" the Trump Administration Grow. The May Revision proposes $13 million General Fund over the next two years for the Attorney General to continue his ongoing efforts to derail the federal government. The proposed funding would primarily support 19 attorneys who would presumably lay the groundwork for the Attorney General to contest the constitutionality of executive actions related to immigration, healthcare, and the environment. From January 20, 2017 to May 8, 2017, DOJ expended more than 13,000 hours of legal time on these efforts, including almost

[8] Raphael, Steven, et al. *The Effects of California's Enhanced Drug and Contraband Interdiction Program on Drug Abuse and Inmate Misconduct in California's Prisons*. April 29, 2017. http://www.cdcr.ca.gov/Reports/docs/External-Reports/Effects-Drug-Contraband-Interdiction-Report_April-29-2017.pdf

1,200 hours on sanctuary jurisdictions, an additional 375 hours specifically on the “sanctuary state” bill (SB 54, De León), nearly 300 hours on immigration executive orders related to travel, and more than 500 hours on “Border Wall Construction Challenges”.

While it is admirable that the Attorney General and the Governor have suddenly gained an appreciation for states’ rights, Senate Republicans believe that the state should work with the federal government to maximize value for Californians, rather than “poking the bear” for political points.

Transportation

Key Points

- **Gas Tax Bait-and-Switch.** The May Revision allocates $2.8 billion from the new gas and car taxes (SB 1), including a bait-and-switch by using hundreds of millions for non-road purposes such as park maintenance.
- **New Costs to Californians for State's ID Card Neglect.** Following years of delays, the May Revision now proposes new costs and fees to implement the federal "Real ID" licenses and identification cards.
- **Motor Voter Implementation Continues.** The May Revision further implements automatic voter registration at the Department of Motor Vehicles (DMV).

Transportation Tax Bait-and-Switch Funds Parks, Other Non-Road Projects. With the increased gas, diesel, and vehicle taxes approved in SB1 expected to add $2.8 billion to state coffers in the budget year, the May Revision proposes the amounts shown in the chart below.

2017-18 New Gas and Car Tax Spending (Dollars in Millions)			
	Program		*Amount*
Local Allocations	Local Streets and Roads		$445.4
	Transit and Intercity Rail Capital Program		$330.0
	State Transit Assistance		$305.1
	Local Partnership Program		$200.0
	Active Transportation Program		$100.0
	Local Planning Grants		$25.0
		Total:	**$1,405.5**
State Allocations	SHOPP/Maintenance		$445.4
	Bridges and Culverts		$400.0
	Congested Corridors		$250.0
	Trade Corridor Enhancement		$199.8
	Department of Parks and Recreation		$54.3
	Freeway Service Patrol		$25.0
	Department of Food and Agriculture		$17.3
	CSU and UC Research		$7.0
	Workforce Development Board		$5.0
		Total:	**$1,403.8**
Administration	State Controller's Office		$0.1
	California Transportation Commission		$0.2
	Department of Motor Vehicles		$3.8
		Total:	**$4.1**
Revenue	Transportation Improvement Fee		$727.0
	Gasoline Excise Tax		$1,251.5
	Diesel Excise Tax		$399.7
	Diesel Sales Tax		$200.1
	General Fund Loan Repayment		$235.0
		Total:	**$2,813.3**

Unfortunately, Democrats have once again misled the public by advertising that the increased taxes and fees would only be used to fix California's crumbling roads and highways. Not a penny of new tax revenue has been collected, and $873 million is already allocated to non-road uses like public transit, walking and biking paths, local planning grant programs, state and local parks, university research programs. Arguably, the most egregious use is $54 million for the Department of Parks and Recreation and to fund a ***local*** park district in Jurupa. Less than a month after the bill became law, the Governor has already broke his promise to fund roads by ripping-off the gas taxes to benefit state employees, ***a local park project***, and park bathrooms.

Growing the Caltrans Bureaucracy. SB 1 increases workload for Caltrans but it's likely the department could absorb the workload with existing positions. As a continued follow-up to a 2014 LAO report that found Caltrans' Capital Outlay Support (COS) program to be overstaffed by about 3,500 positions, last May the LAO indicated the COS program remained overstaffed by at least 1,000 positions but could be overstaffed by more than 2,000 positions. For SB 1 workload, the May Revision proposes to retain 243 positions at a cost of $21.8 million that would otherwise be eliminated.

The Caltrans Fox Guards the Henhouse. Additionally, the May Revision proposes to redirect 48 existing audit positions and add 10 new positions costing $9.4 million for the Caltrans' "Independent Audit and Investigation Office." According to Democrats and the Governor, SB 1 also includes reforms and efficiencies to ensure taxpayer dollars are spent responsibly. But a closer look at the "Independent" Audit and Investigation Office within Caltrans reveals this is nothing more but a name change of the existing Division of Audits and Investigations. The only thing making this office "independent" is the declaration of said independence. The head of this office, the Inspector General, will report to the Director of Caltrans and the Transportation Agency. Despite the fact a Cal Trans internal audit office has existed for many years, Caltrans makes frequent appearances in independent audit reports from the California State Auditor. Several external investigations were also needed for the San Francisco-Oakland Bay Bridge project, indicating the limited effectiveness of Caltrans' own auditors and investigations. Given the continued conflicts of interest, Senate Republicans are concerned the newly renamed Caltrans audit office is mere window dressing.

Department of Motor Vehicles

State Neglect on Federal Real ID Will Cost Californians. California has had ample time to comply with the 2005 federal Real ID law but has failed to do so, resulting in the need to rush to meet the deadline and costing taxpayers hundreds of millions of dollars. The May Revision includes $221 million and 2,750 positions over the next six years for the DMV to offer extended weekday office hours, Saturday office hours, and extend the operation of temporary offices to issue driver's licenses (DL) and identification (ID) cards that would be accepted by the federal Transportation Security Administration to board an airplane starting October 1, 2020. Under the proposal, beginning January 2, 2018, Californians would have an option to apply for federally compliant DL and ID cards. Had the DMV begun issuing compliant cards sooner, residents could have upgraded to the compliant card in their normal cycle of renewal, but now they will need to make a special trip to the DMV and incur another $29-$33 fee to obtain the required card.

New Motor Voter Program. The May Revision includes $7 million ($1.8 million General Fund, $5.2 million Motor Vehicle Account) and 10 positions to continue the development of a fully automated voter registration process that is integrated with DMV's driver's license application and renewal process. The New Motor Voter Program was authorized by Chapter 729, Statutes of 2015 (AB 1461) and establishes a process to automatically register to vote every "eligible" individual that applies for a driver's license, identification card, or change of address unless the individual declines to be registered. Specifically, the proposal will require individuals to submit the application to DMV electronically, either in advance or via a terminal at a DMV office. During the electronic application process, customers would be prompted to complete voter registration information or have an opportunity to opt out. This new process is expected to significantly reduce the number of applicants who only provide partial voter registration information. Senate Republicans remain concerned that this program does not provide sufficient safeguards to ensure only eligible voters are registered.

Resources & Environmental Protection

Key Points

- Gas Tax Bait-and-Switch: The May Revision directs $54 million to state parks.
- Tiny Amount of Tree Mortality Funding Creates Big Public Safety Risk.
- Millions More Needed for Critical Flood Control Infrastructure Projects.

Bait and Switch: Gas Taxes for Parks and Pork, Not Roads. The Administration is proposing to give $54 million of the new gas tax revenue (SB 1) to the Department of Parks and Recreation (DPR) to maintain its properties and to improve access to state parks, establish an employee training program, and fund the ***local*** Jurupa Area Recreation and Park District. This local park district will receive $18 million in gas taxes yet DPR has provided no justification for using the money for that region of the state. Furthermore, these gas tax revenues are derived from fuel purchases by the Off-Highway Vehicle (OHV) and boating communities. However, the Governor's May Revision only gives the OHV and boating programs $1 million each. California motorists, OHV riders, and boaters are all paying more at the pump but not receiving the road or program benefits that they were promised.

The Drought is Over. The Governor has finally acknowledged that 2016-17 has been the wettest on record in the northern Sierra Nevada Mountains. Nearly all of the state's major reservoirs hold above-average storage, and the snowpack is double the historic statewide average. In April 2017, the Governor ended the drought state of emergency in all but four areas of the state. Therefore, the May Revise proposes $62.9 million in mostly one-time drought funding, a decrease of $115.8 million from the January budget. These funds would support drought response activities within various departments for the protection of water supplies, water conservation, water curtailment and enforcement actions, enhanced fire protection, and fish and wildlife protection, as summarized in the chart on the next page. In addition to the funding identified in the chart for the Department of Forestry and Fire Protection, an additional $42 million General Fund is being proposed for ongoing enhanced fire protection activities.

Budget Ignores Dead Tree Crisis. Unfortunately, the Governor has decided once again to make fish a priority over people by cutting funding to tree mortality activities by $44 million while sustaining all of the funding for Delta Smelt resiliency. Recent drought conditions combined with an unprecedented bark beetle outbreak have killed 100 million trees in California forests. To achieve healthy forests throughout California, the state will need more, not less, funding to continue the removal of dead and diseased trees and reduce the chances that catastrophic wildfires will destroy forests, homes, and habitat. Senate Republicans are concerned about the May Revision's elimination of the majority of county assistance to aid in the removal of dead and dying trees that pose a huge public life and safety risk.

Drought Response Funding (Dollars in Millions)				
Investment Category	*Department*	*Program*	*January 10 Budget Amount*	*May Revise Amount*
Protecting Water Supplies and Water Conservation	Department of Water Resources	Local Assistance for Small Communities	$5.0	$5.0
	Water Board	Water Rights Management	$5.3	$0.6
	Department of Water Resources	Drought Management and Response	$7.0	$0.0
	Department of Water Resources	Save Our Water Campaign	$2.0	$1.0
Emergency Response	Department of Forestry and Fire Protection	Enhanced Fire Protection	$91.0	$41.7
	Office of Emergency Services	Emergency Water Tank Program/Tree Mortality	$52.7	$8.5
	Office of Emergency Services	State Operations Center	$4.0	$0.0
Protecting Fish and Wildlife	Department of Fish and Wildlife	At-Risk Fish Monitoring	$8.2	$2.6
	Department of Water Resources	Delta Smelt	$3.5	$3.5
Total			**$178.7**	**$62.9**
Resource: Department of Finance				

The Drought Is Over – Why Aren't the Regulations? At the same time the Governor declared the drought emergency over, he directed the State Water Resources Control Board (SWRCB) to enact **permanent water conservation requirements** on both urban and agricultural water users. These new requirements will set interim and long-term urban water use efficiency standards and require new planning and annual assessments. In addition, agricultural water suppliers providing water to over 10,000 irrigated acres of land will be required to develop annual water budgets, identify water management objectives, create implementation plans, increase water use efficiency, and develop drought plans. The SWRCB is requesting ongoing administrative staffing in the May Revision to implement these new permanent requirements and establish a new conservation unit. The $550,000 in General Fund costs for this new unit will be absorbed with the SWRCB's existing budget as they have **"found"** extra General Fund monies in their budget that they don't need for other purposes. ***Senate Republicans are concerned that the goal of the Administration's conservation efforts is to gain complete command of all water resources by eliminating local control without regard for the harm to local water agencies, irrigation districts, and communities statewide.***

Some Dam Safety and Flood Control Investments. The May Revision includes dam safety and flood control proposals that were submitted in the current year but were never acted upon by the Legislature. The proposals impose new requirements on dam owners to prepare inundation maps and emergency action plans while providing the Department of Water Resources (DWR) with more enforcement authority through the use of fines and dam operational restrictions for failure to comply. In addition, DWR will conduct more extensive evaluations of appurtenance structures, such as spillways, gates, and outlets. The new activities will be funded from $6.5 million in additional annual fees on dam owners.

In addition, $1.9 million of General Fund is proposed for the Office of Emergency Services to review and approve dam related emergency response plans and to coordinate with local emergency management agencies on incorporation into all-hazard emergency plans. The proposal also provides $387 million of Proposition 1 Bond funds for flood protection and habitat restoration projects for the Delta, Central Valley, and coastal areas of the state.

Major Additional Flood Control Investments Needed. Through a bipartisan effort, Senator Nielsen (R-Tehama) has requested $100 million General Fund annually to DWR for critical infrastructure repairs and reimbursements to local agencies for flood control infrastructure work. A consistent source of funding is necessary to address the backlog of operation and maintenance needs across the state, as shown by the severe damage to the Oroville Dam spillways earlier this year. Critical repairs are needed to the Sacramento, Feather, and Yuba River levees along with the Sutter and Yolo Bypasses and to urban and rural flood protection facilities in high flood risk areas across the state. This year alone, local agencies have spent millions of dollars on emergency response activities which need to be reimbursed in order to help them recover from these unexpected financial burdens.

The Central Valley Flood Protection Plan estimates up to $21 billion needed over 30 years for upkeep of the State Plan of Flood Control system of levees and bypasses, while an analysis by the DWR and the U.S. Army Corps of Engineers identified needs of more than $50 billion in a 2013 report. Senator Nielsen's request of $100 million represents the amount of work that can be achieved each year to incrementally reduce this backlog of deferred maintenance needs.

This requested funding investment in our water infrastructure will save lives, protect property, and save the state billions in avoided emergency repairs.

Employee Compensation

Key Points

- **Paying Down Pension Debts Makes Sense.** A proposed $6 billion prepayment loan to CalPERS to reduce future state costs makes sense, though reducing other loan repayments at the same time is less prudent.

- **Teachers' Retirement Fund Lowers Investment Expectations, Raises Costs.** This move follows CalPERS lead and, though necessary, contributes to retiree cost increases.

Paying Down Pension Debt Makes Sense. The May Revision proposes to make a $6 billion supplemental payment to the California Public Employees Retirement System (CalPERS). This payment would be in addition to the $8.9 billion already provided in the budget for CalPERS and CalSTRS (State Teacher Retirement System) contributions.

The Governor believes that this additional payment will allow the state to lower its employer contribution over the next 20 years. This reduced rate will fluctuate from year to year, but is estimated to be about 2.1% lower and save the state $11 billion over 20 years. The $6 billion would be a long-term loan from the state's cash accounts, which would be paid back over time with the General Fund share credited toward Proposition 2's debt repayment requirements. While steps must be taken to address unfunded pension liabilities that are spiraling out of control, counting this supplemental payment towards Proposition 2's requirement to pay down debt could result in other debt repayments being delayed.

Additional State Costs from More Realistic Investment Returns. In 2016 the California Public Employees Retirement System (CalPERS) adopted a phased-in reduction of their projected investment return (also called the discount rate). This approach lowers the discount rate to 7.375 percent for the 2017-18 fiscal year, 7.25 percent for the 2018-19 fiscal year, and 7 percent for the 2019-20 fiscal year. In February of 2017 the California State Teachers Retirement System (CalSTRS) followed suit and adopted a phased-in discount rate reduction from 7.5 to 7% by 2018.

This reduction will significantly increase employer and employee contributions to CalPERS and CalSTRS, especially for employees covered by recent pension reforms. Unfunded liabilities for each system will immediately increase. Unfunded liabilities for CalSTRS increased by $25 billion to a total of $101 billion ($15 billion increase in the state portion to $29 billion) when the discount rate was reduced by a quarter percent. With CalSTRS expecting to receive lower investment returns over the long term, the state will be responsible for making up any shortfall in the fund. The true future cost to taxpayers will be higher since both systems believe that they will only be able to achieve an average return of 6.2 percent over the next 10 years, which will only result in even higher liabilities for the state.

Statewide Issues & Local Government

Key Points

- **Governor Has No Plan for Housing Crisis.** The May Revision does not include any significant policy changes in housing.
- **"Nowhere Money" Raises Concerns.** The May Revision continues to assume the Governor's revised spending limit.
- **Cannabis Protections and Laws Weakened.** The Governor proposes to significantly loosen requirements on the cannabis industry and compromise public safety.

Housing

No Housing Plan Included in May Revision. The Governor's January budget did not propose any significant policy shifts to begin to address the state's housing crisis, and the May Revision continues to remain silent on the most critical policy issue facing the state. Instead, the Governor outlined several guiding principles for reform in January, but staunch opposition from labor and environmental interests make it unlikely that legislative Democrats will support changes that could make significant improvements in California's cost of housing. The Department of Finance projects that annual construction of housing units will barely rise to 115,000 units in the next several years, far below the 180,000 unit production level that would be needed to begin addressing California's housing shortage. **Senate Republicans support a thoughtful approach that includes broader policy changes that deal with the underlying causes of expensive housing, including restrictive environmental reviews, extensive and cost-prohibitive zoning restrictions, and a host of excessive fees.**

State Spending Limit

Governor's "Nowhere Money" Raises Concerns. The Governor's May Revision continues to assume a dramatically higher state spending limit (known as the "Gann limit" or the State Appropriations Limit) that significantly increases the level of spending allowed by the state constitution. The Legislative Analyst's Office raised significant concerns with the Governor's January budget method for calculating the limit, noting that the changes appeared to create $22 billion in extra spending room by treating some spending as "nowhere money" that is not counted, either at the local level or at the state level, as required by the Constitution. In contrast, the method used to calculate the spending limit each year through the 2016 Budget Act would likely show little to no spending room left in 2017-18 given additional May Revision revenues. **Senate Republican are concerned that this significant policy shift likely undercuts constitutional requirements enacted by voters to encourage responsible financial management.**

Cannabis Regulation

Cannabis Protections and Laws Weakened. The May Revision includes $43.2 million and 151 new positions to continue preparations to regulate both the medical and recreational segments of the cannabis industry and begin licensing and enforcement on January 1, 2018. The table on the next page shows the specific funding proposals by department, including funding provided through the current year to reflect program growth:

State Spending on Cannabis Regulation				
Department	**Funding Through 2016-17 (millions)**	**Jan 10 Funding (millions)**	**May Revise Funding (millions)**	**Responsibilities**
Department of Consumer Affairs	$11.3	$22.6	$0.7	Regulate the transportation, storage, distribution, testing, and sale of cannabis within the state; licensing, investigation, enforcement, and coordination with local governments.
Department of Fish and Wildlife	$13.7	-	$17.2	Support regulatory programs implemented by CDFA and Water Board, provide law enforcement for compliance efforts, and issue Lake and Streambed Alteration Permits.
State Water Resources Control Board	$7.2	-	$9.8	Develop a statewide water quality permit and expanded water rights registration process for cannabis cultivators.
Department of Food and Agriculture	$8.6	$22.4	$3.9	License and regulate cannabis cultivation, perform an Environmental Impact Report, and establish a track and trace program.
Department of Public Health	$4.6	$1.0	$9.3	License and regulate of cannabis product manufacturers.
Department of Pesticide Regulation	$0.7	-	$1.3	Develop guidelines for the use of pesticides in the cultivation of cannabis, prepare training programs and outreach materials.
Board of Equalization	$1.1	$5.4	-	Administer an excise tax on cannabis sales and a cultivation tax on all harvested cannabis that enters the commercial market.
Department of Health Care Services	$5.0	-	-	Establish and implement a public information program relative to cannabis health-related topics and products.
Cannabis Appeals Panel	-	-	$1.0	Review all appeals related to cannabis licensing decisions.
Total	$52.2	$51.4	$43.2	Total funding through 2017-18 $146.8 million.

Cannabis Proposals Would Weaken Public Safety. The Governor has proposed significant policy changes through trailer bill language that **loosen requirements on the cannabis industry and compromise public safety**. This trailer bill is advertised as a means to create a single regulatory structure for medical and recreational cannabis while protecting public and consumer safety and safeguarding local control. However, a close look at the proposals reveals a plan that:

1. Deletes current laws that help keep neighborhoods and children safe.
2. Increases the opportunity for cannabis products to enter the black market.
3. Eliminates industry checks and balances.
4. Continues special treatment of cannabis over other types of agricultural products.
5. Rolls back fire safety and environmental protections placed on the cannabis industry.

Senate Republicans share local government and law enforcement concerns about these proposed changes. In this new world of legal cannabis consumption, Senate Republicans will continue to advocate for laws that both enhance the health and safety of Californians and treat cannabis products similar to other agriculture producers.

Debts and Liabilities

The Governor's May Revision includes $8 billion to pay the state's current debts and liabilities, including the following components:

- $6.2 billion to pay debt service costs for the state's outstanding and planned General Obligation (GO) and Lease Revenue (LR) bonds in 2017-18. According to the State Treasurer, the state currently has outstanding bonds totaling about $84 billion. With the passage of the recent Public School Facility Bonds (Proposition 39, 2016), GO debt service costs will continue to rise.

- $1.8 billion to pay a variety of debts and liabilities as mandated by Proposition 2, which was passed by voters in November 2014.

The Governor's May Revision does not make any headway in paying down suspended mandates, such as the six critical election mandates that remain suspended (the state owes about $75 million) or education mandates, which remain at $2 billion in 2017-18. The May Revision does include a one-time $6 billion payment to CalPERS to pay down the unfunded liability, but the loan is not included in the debts and liabilities calculation (see Employee Compensation section on page 26 for additional information). However, repayment of the General Fund share of the $6 billion loan will be eligible for Proposition 2 payments in future years. While the prepayment makes sense, counting repayment of the loan against Proposition 2 requirements likely means that repayment of other debts will be delayed. **Given California's high levels of debt and liabilities, it would be more prudent to pay down the prepayment loan in addition to other Proposition 2 debt payments.**

The chart on the next page identifies the state's current outstanding debts and liabilities, projected repayment over the next few years, and remaining balances:

Statewide Debts and Liabilities *(Dollars in Millions)*	**At Start of 2017-18**	**Estimated Payments 2017-18**	**2018-19**	**2019-20**	**2020-21**	**Remaining Liabilities***
Eligible for Proposition 2 Payments						
Budgetary Borrowing						
Loan from Special Funds*	$1,365	$252	$465	$407	$241	$0
Underfunding of Proposition 98 - Settle-Up	1,043	603	291	149	0	$0
Pre-Proposition 42 Transportation Loans	706	235	235	236	*0*	$0
State Retirement Liabilities						
State Retiree Health	76,533	89	200	250	300	N/A
State Employee Pensions	59,578	427	209	230	666	N/A
Teachers' Pensions (state portion)	29,332	0	0	0	0	N/A
Judges' Pensions	3,489	0	0	0	0	N/A
Deferred payments to CalPERS	627	0	0	0	0	N/A
University of California Retirement Liabilities**						
UC Employee Pensions	15,141	169	0	0	0	N/A
UC Retiree Health	21,860	0	0	0		N/A
Unallocated Debt Payments					627	-$627
Subtotal, Eligible for Proposition 2	**$209,674**	$1,775	$1,400	$1,272	$1,834	
Other State Debts						
Long-Term Infrastructure (General Obligation & Lease-Revenue Bonds)	$83,887	$6,222	$0	$0	$0	$77,665
Unemployment Insurance	3,900	50	0	0	0	$3,850
Suspended Mandate	1,016	0	0	0	0	$1,016
Education Mandate	2,025	0	0	0	0	$2,025
Subtotal, Other State Debts	**$90,828**	$6,272	$0	$0	$0	
Total	**$300,502**	$8,047	$1,400	$1,272	$1,834	

* Assumes no additional debts incurred.

** UC liabilities are technically liabilities of the UC system alone, not the State of California, due to UC's constitutional autonomy, but these liabilites are nonetheless included as eligible for repayment under Proposition 2.

Appendix

General Fund Solutions in 2017-18 May Revision
(Dollars in Millions)

		Governor's Budget		May Revision				
Department	**Spending Adjustment**	**2016-17**	**2017-18**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**
Education	Adjust Proposition 98 to Minimum Guarantee (Jan); Suspend "Test 3b Add-On" (May)	$1,054	$641	$347	$360	$826	$1,147	$1,294
Housing and Community Development	Recognize affordable housing funding not authorized due to lack of "By Right" reform	$400	$0	$400	$0	$0	$0	$0
Various	Avoidance of various new proposals*	$0	$329	$0	$329	$127	$276	$286
General Services	Cancel 2nd year of funds for Sacramento office buildings	$0	$300	$0	$300	$0	$0	$0
Education	Pause Child Care Rate Augmentations	$0	$104	$0	$0	$0	$0	$0
California Health Facilities Financing Authority	Eliminate Community Infrastructure Grants	$68	$0	$68	$0	$0	$0	$0
Social Services	Eliminate Funding for Housing and Disability Income Advocacy Program	$44	$1	$44	$1	$1	$0	$0
California Student Aid Commission	Make Middle Class Scholarship Awards to Renewal Students Only	$0	$36	$0	$32	$78	$92	$115
Office of Statewide Health Planning and Development	Elimination of Health Care Workforce Augmentation	$33	$33	$33	$33	$33	$0	$0
Health Care Services	Major Risk Medical Insurance Fund Abolishment and Balance Transfer	$0	$65	$0	$47	-$10	-$9	-$8
California Health Facilities Financing Authority	Reduction of Children's Mental Health Crisis Services Grants	$17	$0	$17	$0	$0	$0	$0
Natural Resources Agency	Reversion - Arts Council Grants	$5	$0	$0	$0	$0	$0	$0
Energy Commission	Low Carbon Fuel Research (Lawrence Lab)	$3	$0	$0	$0	$0	$0	$0
Water Resources	Reversion for Atmospheric Rivers Research	$3	$0	$0	$0	$0	$0	$0
Social Services	CalWORKs—Cease Integration of Online Appraisal Tool	$3	$9	$0	$9	$3	$3	$3
Social Services	Delay Adoption of CalWORKs Welfare-to-Work 25/25A Report	$0	$6	$0	$6	$0	$0	$0
Rehabilitation	Eliminate Supplemental Funding for Three Independent Living Centers	$0	$1	$0	$1	$1	$1	$1
State Parks	Elimination of Micke Grove Grant	$1	$0	$0	$0	$0	$0	$0
Veterans Affairs	Reduce Veteran Services Support	$0	$2	$2	$2	$2	$2	$2
Total		**$1,630**	**$1,525**	**$910**	**$1,119**	**$1,061**	**$1,512**	**$1,693**

* Details not provided by Department of Finance at time of publication.

Senate Republican Fiscal Staff Assignments

Kirk Feely, Fiscal Director
Andrea Mullen, Budget Committee Assistant

Contact Number: (916) 651-1501

Assignment Area	Consultant
Education	Cheryl Black
Public Safety, Judiciary, Corrections	Matt Osterli
Natural Resources & Environment	Rocel Bettencourt
Health and Human Services	Anthony Archie
Public Employees Retirement, State Government, Veterans and Labor & Industrial Relations	Scott Seekatz
Revenue, Local Government, Housing, Taxes	Chantele Denny
Transportation, Energy & Consumer Affairs	Heather White

For more information, please visit our website at http://cssrc.us/newsroom/fiscal/current