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First Look

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Governor's May Revision Stresses Fiscal Restraint; Policymakers Can Find Room for More Investment

On May 13, Governor Jerry Brown released the May Revision to his proposed 2016-17 state budget. Lower-than-expected revenues result in estimated General Fund spending of $122.2 billion, more than $400 million below the Administration's January proposal. The May Revision stresses fiscal caution and – like the Governor's January proposal – is framed by the pending expiration of the Proposition 30 income tax increases approved by voters in 2012 as well as by efforts to build the state's rainy day fund.

The Governor's May Revision points to a coming budget shortfall if the Prop. 30 income tax increases are allowed to expire, noting that "[i]f…voters do not pass the extension of taxes, the state will need to cut spending." The May Revision sets aside $2.6 billion in revenues, with half deposited in the state's rainy day fund and half used to pay down state debts, as required by Proposition 2 (2014). However, the Governor's revised budget also includes some *discretionary* set-asides that leave significantly less funding available for other state priorities. These choices include placing an additional $2 billion in the rainy day fund *beyond* Proposition 2's requirements, depositing $1.8 billion in a different state reserve, and allocating $1.5 billion from the General Fund this year for state buildings projects.

In a significant advance, the May Revision adopts a Senate plan that would issue $2 billion in bonds for constructing housing for chronically homeless persons with mental illness. This effort to address one facet of California's housing affordability crisis builds on progress made in recent years in enacting policies to address barriers to economic opportunity. These include the recent agreement to increase the state minimum wage to $15 by 2022-23 and last year's creation of a state Earned Income Tax Credit (EITC). Other advances include expanding Medi-Cal, most recently to undocumented children, and restructuring California's K-12 finance system to provide additional resources to support disadvantaged students.

Yet at the same time, the Governor's heavy emphasis on fiscal caution means that as lawmakers work to finalize a 2016-17 spending plan, they have ample opportunity to find room in the budget for more progress in investing in economic opportunity and financial security. Key improvements could include increasing support for subsidized preschool and child care, repealing the Maximum Family Grant rule in CalWORKs, and boosting funding for the CalWORKs Housing Support Program.

The following sections summarize key provisions of the Governor's revised 2016-17 budget. Please check the Budget Center's website (calbudgetcenter.org) for our latest commentary and analysis.

Economic Growth Expected to Continue, Administration Revises Revenue Projections Downward

California's steady economic recovery continues, with further growth expected over the next few years. The Administration now projects the state average annual unemployment rate will be 5.3 percent in 2016, down from January's projection of 5.7 percent. The Administration also notes that the labor force participation rate "has been rising, indicating optimism among workers." At the same time, uncertainty about the world economy poses some risk to California, and the stock market has experienced ups and downs recently, contributing to lower-than-expected revenues.

Following lower-than-expected tax receipts in April, the Administration has reduced its projection of General Fund revenue for 2016-17 downward by $918 million. (This is before transfers to the state's rainy day fund.) Over the three-year "budget window," from 2014-15 to 2016-17, projected pretransfer General Fund revenue is now $1.9 billion lower than assumed in January, although still above the forecast from last year's Budget Act. Reductions in projected revenue for 2015-16 and 2016-17 were offset by higher-than-expected revenues of about $471 million in 2014-15, mostly in corporate income tax receipts.

Although revenue from high-income taxpayers and the concentration of income among these taxpayers are still growing, these increases have been modestly slower than expected. Fluctuations in the stock market affects capital gains realizations, and high-income earners tend to derive more of their income from capital gains. Projections of capital gains realizations have been reduced by $15 billion and $10 billion for tax years 2015 and 2016.

Governor's Revised Proposal Continues to Set Aside $2 Billion More Than Is Required by Proposition 2

California voters approved Proposition 2 in November 2014, amending the California Constitution to revise the rules for the state's Budget Stabilization Account (BSA), commonly referred to as the rainy day fund. Proposition 2 requires an annual set-aside equal to 1.5 percent of estimated General Fund revenues. An additional set-aside is required when capital gains revenues in a given year exceed 8 percent of General Fund tax revenues. For 15 years – from 2015-16 to 2029-30 – half of these funds will be deposited into the rainy day fund, and the other half will be used to reduce certain state liabilities (also known as "budgetary debt").

The Governor's proposed 2016-17 budget projects that by the end of the current fiscal year (2015-16) the BSA reserve will total $3.4 billion. Based on the Governor's revenue projections for 2016-17, Proposition 2 would constitutionally require the state to set aside an additional $2.6 billion ($1.3 billion to the BSA and $1.3 billion to repaying budgetary debt). Yet even beyond the constitutional requirements of Proposition 2, the Governor proposes an *additional* transfer to the BSA of $2 billion, bringing the state's rainy day fund to $6.7 billion by the close of 2016-17.

The BSA is not California's only reserve fund. Each year, the state deposits additional funds into a "Special Fund for Economic Uncertainties." For 2016-17, the Governor's proposes to allocate $1.8 billion to this fund. Including this fund, the Governor's proposal would build state reserves to a total of $8.5 billion in 2016-17.

The choice to allocate additional General Fund revenues to the BSA, beyond what is required by Proposition 2, means that significant funding is not available to invest in other vital public systems and services.

May Revision Keeps Set-Aside of $1.5 Billion for Renovation of State Buildings

The Governor's May Revision retains the January proposal to use $1.5 billion of the General Fund as a "down payment" to renovate state office buildings in Sacramento, including the State Capitol Annex. This proposal diverges from the more common state practice of issuing lease-revenue bonds – money the state borrows and then pays back over a number of years – to finance the construction and renovation of state facilities. The Governor's choice to use a one-time General Fund allocation for the renovation of buildings rather than issue bonds means that the costs of financing the projects identified in his budget proposal would be concentrated in the upcoming budget year, rather than spread out over time. As a result, fewer General Fund dollars would be available to support other state priorities in 2016-17.

May Revision Reflects the State's Recently Revised Managed Care Organization (MCO) Tax

California taxes certain managed care organizations (MCOs) and uses the proceeds to (1) bring in more than $1 billion in federal funds each year to support health care services through Medi-Cal and (2) reduce – or "offset" – *state* spending on Medi-Cal by over $1 billion per year, with these freed-up dollars used to support other state priorities. In February, state policymakers revised the MCO tax in order to comply with new federal guidelines. This revised tax will be in effect from July 1, 2016, through June 30, 2019. The MCO tax package also *reduces* two taxes that health plans would typically pay – the insurance tax and the corporation tax – resulting in net savings for the health plan industry.

The May Revision reports that the MCO tax is expected to reduce General Fund spending on Medi-Cal by approximately $1.1 billion in 2016-17. The revised budget also reflects several significant General Fund investments "made possible" by the MCO tax, including $287 million to support services for people with developmental disabilities, $240 million to pre-fund future retiree health care benefits, and $135 million to increase certain Medi-Cal reimbursement rates.

Governor Adopts Proposals to Issue $2 Billion in Bonds for Construction of Housing for Homeless

The high cost of housing remains a significant challenge for Californians. The Governor's May Revision adopts a Senate plan that would issue $2 billion in bonds to support the construction of permanent housing for chronically homeless persons with mental illness. These bonds would be repaid with revenues from Proposition 63 (2004), which generates funds for mental health services through a surtax on very high incomes. The Department of Housing and Community Development (HCD) would develop and administer the program through the Mental Health Services Act – Supportive Housing Program and the Tenant-Based Rental Assistance Program. First-year funding from bond proceeds for the program in 2016-17 is proposed at $267 million.

The Governor's proposal does not include additional elements contained in the Senate housing plan, such as a pilot program to reduce homelessness among families in the child welfare system, increased funding for the CalWORKs Housing Support Program, and increased Supplemental Security Income/State Supplementary Payment (SSI/SSP) payments, which the Senate proposed in order to prevent seniors and people with disabilities from becoming homeless.

May Revision Proposes Legislation to Facilitate Construction of Affordable Housing

In order to further facilitate the construction of affordable housing, the May Revision proposes legislation that would require ministerial, "by-right" land use entitlement provisions for multifamily infill housing developments that include an affordable housing component. These provisions are intended to improve the pace of affordable housing construction by restricting local governments' ability to require various permits or to use other local government review processes for qualifying developments that include affordable housing. Such provisions would streamline the approval of affordable housing, provided that the development is consistent with planning and zoning standards and, where applicable, not subject to mitigating measures to address potential environmental harm.

Governor's May Revision Provides Additional Funds to Boost Participation in the CalEITC

The Administration reports that as of April 2016, more than 350,000 households claimed the new California Earned Income Tax Credit (CalEITC), a refundable state tax credit for low-earning workers that was established by the 2015-16 budget agreement and first became available in the 2015 tax year. This represents just over half of the 600,000 households that the Franchise Tax Board (FTB) estimated would claim the credit. In order to increase participation in the CalEITC in subsequent tax years, the May Revision proposes to provide $2 million to the FTB "to support additional outreach and marketing" – a notable increase in support for outreach efforts. (The 2015-16 budget agreement only provided $600,000 to the FTB for outreach.) The May Revision does not provide any details on exactly how this $2 million allocation would be spent, but the Senate Budget and Fiscal Review Committee specifies that it would be re-granted to other state and local agencies as well as nonprofits and community-based organizations. The Administration also estimates – based on preliminary data – that more than 68,000 tax filers that were eligible for the credit in 2015 failed to claim it, but does not indicate what efforts will be made to encourage these filers to submit amended tax returns in order to benefit from the credit.

The May Revision also reflects a revised estimate of the "cost" – in foregone state revenues – of the CalEITC. Budget documents suggest that in its first year of implementation, the credit reduced personal income tax revenue by $295 million – substantially less than the $380 million annual reduction in revenues expected when the credit was signed into law last year.

The Administration also notes that 57,000 households that claimed the CalEITC as of April 2016 had not previously filed a California tax return and that many of these first-time filers probably claimed the *federal* EITC as well. This is noteworthy because the federal credit reaches only about three-quarters of eligible households in California, and increased federal EITC claims bring additional federal dollars into the state.

Governor's May Revision Reflects Recently Enacted Increase in State Minimum Wage

The May Revision reflects an additional $39.4 million in General Fund costs in 2016-17 due to an increase in the state's minimum wage from $10 per hour in 2016 to $10.50 per hour in 2017. This increase is the first in a series of raises recently signed into law by the Governor under a plan to gradually boost the minimum wage to $15 per hour as soon as 2023. These additional state costs reflect the net impact of increased state worker wages, increased state payments to In-Home Supportive

Services providers and developmental disability service providers, and modest state savings due to fewer people participating in Medi-Cal and CalWORKs as a result of their higher earnings.

The Administration also suggests that General Fund costs will increase by an estimated $3.4 billion once the state minimum wage reaches $15 per hour. However, it is important to note that estimating the impact of a higher minimum wage on the state budget requires numerous assumptions and is subject to great uncertainty. Last year, the Legislative Analyst's Office examined a ballot initiative that would have raised the state's minimum wage to $15 per hour by 2021 – similar to the increase recently enacted into law – and estimated that it could potentially reduce state and local tax revenues by hundreds of millions of dollars but also might *increase* those revenues by more than a billion dollars.

Governor's May Revision Fails to Substantially Invest in CalWORKs

The California Work Opportunity and Responsibility to Kids (CalWORKs) Program provides modest cash assistance for nearly 1 million low-income children while helping parents overcome barriers to employment and find jobs. The Governor's May Revision reflects a 1.4 percent increase in CalWORKs grants effective October 1, 2016. This is as required by the 2013-14 budget agreement, which specified that special fund "growth dollars" from the 1991 "realignment" would be used to automatically provide CalWORKs grant increases as funds become available. The Administration estimates that enough funds are available to provide a 1.4 percent grant increase for nine months of the budget year. Under this proposal, the maximum monthly grant for a family of three in a high-cost county would increase modestly, from $704 to $714, but remain $9 below its prerecession level.

Although the Governor's plan to slightly increase CalWORKs grants is welcome news for low-income families, the Administration fails to provide any additional support in 2016-17 to the CalWORKs Housing Support Program (HSP). This is despite the fact that the maximum CalWORKs grant for a family of three falls far short of the amount needed to afford low-cost rent in California. Advocates have called for increased investment in the HSP in order to allow more families to find stable housing and avoid homelessness.

Additionally, the Administration does not propose ending the Maximum Family Grant (MFG) or "family cap" rule, which is widely regarded as punitive and racist, and serves only to drive families with children deeper into poverty. Senate Bill 23 (Mitchell) would repeal this rule, and a diverse range of over 70 organizations have submitted letters to policymakers advocating for its repeal through the state budget. The Assembly recently proposed to end the MFG rule and raise CalWORKs grants by 4 percent, primarily using special fund growth dollars from the 1991 realignment to cover the resulting costs, with any remaining costs covered by the General Fund. Because this special fund is expected to increase over time, it should eventually be sufficient to cover the full cost of these policy changes, with no impact on the General Fund. The Senate has not yet taken action on this proposal.

Governor Maintains Proposal to Modestly Increase SSI/SSP Grants in 2017

Supplemental Security Income/State Supplementary Payment (SSI/SSP) grants help 1.3 million low-income seniors and people with disabilities to purchase food, housing, and other basic necessities. State support for SSI/SSP grants – which are funded with both federal (SSI) and state (SSP) dollars – has been significantly cut in recent years, reducing recipients' ability to make ends meet. State policymakers eliminated the annual state cost-of-living adjustment (COLA) and cut the SSP portion of the grant to the minimum levels allowed by federal law ($156 for individuals and $396 for couples). Consistent with the Governor's January proposal, the May Revision includes a state COLA of 2.76 percent that would be applied to the SSP portion effective January 1, 2017, at a General Fund cost of $36.5 million in 2016-17.

May Revision Reflects New Exemptions From Overtime Rules in the In-Home Supportive Services Program

Many seniors and people with disabilities rely on the In-Home Supportive Services (IHSS) Program, which helps people with low incomes remain safely in their own homes, preventing the need for more costly out-of-home care. IHSS enrollment is projected to reach roughly 490,000 in 2016-17, up from the current level of about 467,000.

The May Revision reflects two new exemptions from IHSS overtime rules. On Feb. 1, 2016, the state implemented new federal labor regulations that mandate overtime pay for home care workers, including IHSS providers, and require that workers be paid for time spent in transit between multiple consumers and at medical appointments. IHSS providers are now paid overtime for working more than 40 hours per week, but under state law are limited to a 66-hour workweek. However, on May 1, the Administration implemented two exemptions that allow certain providers to exceed the weekly limit on hours. One exemption applies to certain "live-in family care providers" who care for two or more disabled minor or adult children or grandchildren. The other exemption applies to IHSS recipients who face "extraordinary circumstances" and are at risk of "out-of-home institutionalized care." In both situations, providers who qualify for an exemption may work up to 12 hours per day or 90 hours per week, not to exceed 360 hours per month, according to a budget document prepared by the Department of Social Services. These exemptions are estimated to increase state General Fund costs for IHSS by $22.3 million in 2016-17.

May Revision Highlights Expansion of Medi-Cal to Undocumented Immigrant Children and Youth

Medi-Cal, California's Medicaid program, provides health care services to 13.5 million Californians who have low incomes. Enrollment in Medi-Cal has increased by more than three-quarters since 2011-12, due primarily to the implementation of federal health care reform and to the elimination of the Healthy Families Program (HFP), which shifted hundreds of thousands of children from the HFP to Medi-Cal.

The May Revision highlights the expansion of comprehensive Medi-Cal coverage to undocumented immigrant children and youth, which is scheduled to take effect in mid-May. Currently, undocumented immigrants generally are prohibited from signing up for comprehensive – or "full scope" – health care coverage through Medi-Cal. Instead, these immigrants may receive only "restricted scope" services, such as emergency and pregnancy-related care. The 2015-16 budget package expanded eligibility for Medi-Cal by allowing undocumented immigrants who are age 18 or younger to sign up for full-scope coverage so long as they are otherwise eligible for the program. (Those age 19 or older generally continue to qualify only for restricted-scope benefits.) This change is projected to benefit 185,000 children and youth in California, increasing General Fund spending by $22.8 million in 2015-16 and by $188.2 million in 2016-17.

May Revision Includes a Plan to "Streamline" the State's Subsidized Child Care System

California's system of subsidized child care helps prepare children for school and provides affordable care so parents can find jobs and remain employed. Eligible families can access subsidized child care either through a provider that contracts directly with the state or by using a voucher to access care from providers of their choice. Contract and voucher providers have different licensing requirements and separate payment systems.

The Governor does not propose any new state investments in the subsidized child care system. However, the May Revision expands a proposal, introduced in January, to transition exclusively to a voucher-based payment system over the next five years. Under the revised proposal, the California Department of Education (CDE) would develop – by May 1, 2017 – "a set of recommendations to streamline the existing subsidized child care system … using vouchers as the method of subsidy." Working in consultation with various stakeholders, the CDE would be required to recommend a single payment system "that reflects the variations in the cost of doing business across the state," a "single set of minimum quality and program guidelines" for all providers by setting, and ways to increase efficiencies for both parents and providers. The CDE also would have to develop a plan showing how these changes could be implemented by 2019-20. The CDE's package of proposals would have to avoid increasing the state's costs for subsidized child care or reducing the number of child care slots available statewide.

May Revision Details Plan for Early Education Block Grant

The May Revision details the Administration's January proposal to consolidate funding for the California State Preschool Program (CSPP) and the Transitional Kindergarten (TK) program into an Early Education Block Grant that would support subsidized preschool for certain four-year-olds. (In a change from the Governor's January budget proposal, funding for the CSPP Quality Rating and Improvement System (QRIS) is no longer included in the block grant.) The Governor proposes to implement the block grant in 2017-18 – one year later than originally planned – with TK eliminated as of July 1, 2017. Initial block grant funding would be set at $1.6 billion, which represents no significant additional investment in early learning programs. The Governor's revised budget also includes $20 million in Proposition 98 funds (of which $10 million would be ongoing) to assist County Offices of Education (COEs) with the transition to the new block grant.

According to "trailer bill" language released by the Administration, the Governor's Early Education Block Grant proposal:

- **Specifies that funding would be allocated to school districts and COEs** to administer subsidized preschool programs. School districts may contract with other providers, such as community-based organizations (CBOs) and COEs, to operate preschool services funded through the block grant. In contrast, under the current system, CBO preschool providers may contract directly with the state.
- **Requires school districts to develop community early learning plans and requires COEs to develop regional early learning plans.** School districts must adopt their plans on or before July 1, 2018 and must include annual goals for increasing access to preschool, especially among low-income and at-risk children. COEs must develop and present for adoption their plans on or before October 1, 2017 and must include an assessment of the "early learning needs" in the county and a description of the county's annual goals for increasing access to "high-quality, full-day pre-kindergarten education." These plans would be effective for three years beginning in 2018-19, according to Administration officials, and must be annually updated.
- **Prioritizes services for children whose fourth birthday is on or before September 1 in the year in which they plan to enroll in preschool and who are "at-risk" or "low-income."** At-risk children include those who are homeless, are in foster care, have "exceptional needs," and/or

are English learners. Low-income children are those whose family incomes qualify them for free or reduced-price meals or for subsidized child care. (Unlike the Governor's January proposal, local providers would not have the flexibility to define "low-income.")

- **Allows school districts and COEs to use block grant funds to serve other children** who are under age 5 if all prioritized children who want to attend preschool are already attending and if school districts or COEs have "actively promoted" the programs to eligible families and taken "reasonable steps" to ensure that programs are convenient for eligible families to access.
- **Prohibits providers from charging a family fee for children who enroll through one of the priority categories.** However, providers may establish fees for other children who enroll "if the purpose of the fee is to expand access to or improve services in the program."
- **Requires, beginning in 2018-19, that school districts serve at least as many children through the new block grant as were enrolled in CSPP and TK in 2016-17**, adjusted annually for the percent change in K-3 average daily attendance.
- **Maintains a temporary "hold harmless" provision with respect to the base level of block grant funding allocated to school districts and COEs.** This provision specifies that participating school districts shall receive as much funding from the block grant as they received for CSPP and TK in 2016-17, subject to an annual COLA. School districts' share of funding would include dollars provided to preschool operators located in the school district that formerly contracted directly with the state. Similarly, participating COEs shall receive as much funding from the block grant as they received from the CSPP in 2016-17, subject to an annual COLA. However, beginning in 2020-21, a school district's or COE's block grant funding could be reduced if it served fewer children than were enrolled in CSPP and TK in 2016-17, adjusted annually for the percent change in K-3 average daily attendance. Any reduction in funding would be limited to 5 percent per year.
- **Requires that any increase in base funding for the block grant – beyond the COLA – be distributed to school districts based on "unmet need."** Specifically, funds would be distributed proportionately based on an estimate of each school district's number of unserved low-income and at-risk children, according to the Legislative Analyst's Office. The block grant establishes a per pupil funding rate of $6,200 per year for each additional low-income or at-risk child served and specifies that this amount would be subject to an annual COLA.
- **Outlines various requirements for preschool programs supported with block grant dollars.** For example, preschool programs funded with block grant dollars would have to operate for a minimum of three hours per day and 180 days per year. In addition, they would have to meet at least a Tier 4 rating on the county's QRIS matrix.

- **Allows school districts to determine preschool program curricula.** However, school districts would be "strongly encouraged" to use the Preschool Learning Foundations and to provide a curriculum "that socially and emotionally prepares children" for kindergarten.
- **Requires an assessment at least once every three years by an "independent entity" appointed by the Legislature** to determine "the level of equity of opportunities for subsidized pre-kindergarten across the state."

Increased Revenues Slightly Lift the Minimum Funding Level for Schools and Community Colleges

Approved by voters in 1988, Proposition 98 constitutionally guarantees a minimum level of funding for K-12 schools, community colleges, and the state preschool program. The Proposition 98 guarantee tends to reflect changes in state General Fund revenues, and due to revised revenue estimates in the May Revision, the Governor assumes total Proposition 98 funding over the three-year "budget window" of 2014-15 through 2016-17 that is $626 million higher than assumed in his January budget proposal. Specifically, the May Revision assumes a 2016-17 Proposition 98 funding level of $71.9 billion, $288 million above the Governor's January budget; a 2015-16 Proposition 98 funding level of $69.1 billion, $125 million *less than* January; and a 2014-15 Proposition 98 funding level of $67.2 billion, $463 million more than January.

California's school districts, charter schools, and county offices of education (COEs) provide instruction to approximately 6.2 million students in grades kindergarten through 12. The May Revision proposes to expand increases in funding for the state's K-12 education funding formula – the Local Control Funding Formula (LCFF) – and to pay off outstanding obligations to school districts. Specifically, the May Revision:

- **Provides an additional $154 million, for a total of $3.0 billion, to continue implementation of the LCFF.** The LCFF provides school districts, charter schools, and COEs a base grant per student, adjusted to reflect the number of students at various grade levels, as well as additional grants for the costs of educating English learners, students from low-income families, and foster youth. The May Revision would provide additional LCFF funding above the $2.8 billion increase proposed in January. The Governor's proposal to increase LCFF funding may reduce the amount of time it takes to fully implement the LCFF, which depends on funding that is sufficient for all districts to reach a target base grant (all COEs reached their LCFF funding targets in 2014-15). According to the Administration, the proposed 2016-17 LCFF funding level would bring the LCFF "formula to 95.7 percent of full implementation."

- **Provides an additional $134.8 million in one-time funding, for a total of $1.4 billion, to reduce mandate debt the state owes to schools.** Mandate debt reflects the cost of state-mandated services that school districts, charter schools, and COEs provided in prior years, but for which they have not yet been reimbursed.
- **Provides $100 million in one-time Proposition 98 funding to establish a loan program for emergency repairs to school facilities.** The May Revision would provide temporary funding to school districts to replace or repair facilities due to imminent health and safety issues. The May Revision states that as a condition of participation in the loan program, "a school would have to provide independent verification that the school site has been deemed unsuitable for occupation, and the school would have to self-certify that no alternative facilities are available."
- **Eliminates COLAs for non-LCFF programs for a spending reduction of $22.9 million.** The Governor's January budget proposal had funded a 0.47 percent COLA for the state preschool program and for several categorical programs that remain outside of the LCFF, including special education, child nutrition, American Indian Education Centers.

California's community colleges (CCCs) help prepare approximately 2.3 million full-time students to transfer to four-year institutions as well as obtain training and skills for immediate employment. The May Revision provides funding to support CCC operating expenses, increases funding for CCC general-purpose apportionments, and, consistent with the January budget proposal, reduces mandate debt the state owes to CCCs. Specifically, the May Revision:

- **Provides $75 million for CCC operating expenses.** The May Revision provides funding for the CCCs to pay for increased expenses in areas such as employee benefits, facilities, and professional development.
- **Increases apportionment funding by $80.1 million over two years.** The May Revision increases 2016-17 apportionments – which provide general purpose funding for CCCs – by $41.5 million to reflect revised enrollment estimates at the City College of San Francisco. The May Revision also increases 2015-16 apportionments by up to $38.6 million in anticipation of a shortfall in property taxes from redevelopment agencies. In the event that this shortfall does not occur, any funds not needed to cover the anticipated property tax shortfall would become available to pay for mandate debt the state owes to CCCs.
- **Eliminates COLAs for apportionments, for a spending reduction of $29.3 million.** In addition to eliminating the Governor's January budget proposal to fund a 0.47 percent COLA for apportionments, the May Revision reduces spending by $1.3 million by eliminating the January budget proposal to provide a 0.47 percent COLA for the Disabled Student Programs and Services, Extended Opportunity Programs and Services, Special Services for CalWORKs Recipients, and the Child Care Tax Bailout program.

- **Provides an additional $29.2 million in one-time funding, for a total of $105.5 million, to reduce mandate debt the state owes to CCCs.** Mandate debt is the cost of state-mandated services that CCCs provided in prior years, but for which they have not yet been reimbursed.

May Revision Provides Funding Increases for Higher Education on Top of Those Proposed in January

The Governor's January budget proposal continued a multiyear plan that modestly increased General Fund spending for the California State University (CSU) and the University of California (UC), with the expectation that CSU and UC would improve performance standards and avoid tuition and fee hikes. In addition to the funding provided in January's proposed budget, the May Revision also:

- **Provides a one-time increase for CSU of $25 million in 2016-17 contingent on the trustees adopting plans and timeframes for improving graduation rates.** This funding is freed up from the Middle Class Scholarship Program, which the Administration expects will not use all of its 2015-16 funding allocation in awards.
- **Increases ongoing annual funding for CSU by $1.1 million to support the CSU Student Success Network.** The network would be led by CSU faculty, staff, and administrators and help them to learn from other campuses' experiences.
- **Assumes UC will meet an enrollment target, thereby triggering a $25 million increase in state funding.** The 2015-16 budget agreement included a provision for an additional $25 million in ongoing funding contingent on UC providing "sufficient evidence" by May 1, 2016 that resident undergraduate enrollment will have increased by 5,000 over its 2014-15 level by the 2016-17 academic year. Although systemwide UC resident freshman and transfer enrollment figures presented in the Assembly Budget Subcommittee on Education Finance earlier this month projected an overall increase of 5,050 between the 2014-15 and 2016-17 academic years, systemwide resident freshman and transfer enrollment actually *decreased* by 1,678 between 2014-15 and 2015-16.
- **Provides a one-time increase of $4 million for UC in 2016-17 to expand online classes for middle and high school students, aimed at improving college preparedness.**

The May Revision also reduces projected costs of the Cal Grant program – down $50.9 million in General Fund dollars for 2015-16 and $101.6 million in 2016-17. Middle Class Scholarship Program costs are also expected to be lower for 2015-16, by $33.5 million, based on the number of awards offered. The May Revision uses $25 million of this unspent funding allocation for a one-time increase in CSU funding, as mentioned above.

Governor Modestly Boosts His Estimate of State Savings From Prop. 47, but Updated Projection Remains Low

The number of people incarcerated by the state has dropped by more than one-quarter since peaking at over 173,000 in 2007. This substantial reduction resulted largely from a series of policy changes adopted by state policymakers and the voters in the wake of a 2009 federal court order that requires California to reduce overcrowding in state prisons. These changes include voter approval of Proposition 47 in 2014, which, among other things, reclassified certain nonviolent drug and property crimes as misdemeanors. Because of Prop. 47, state prison is generally no longer a sentencing option for these offenses. The state savings from reduced incarceration – as determined solely by the Governor's Department of Finance – must be allocated to local mental health and drug treatment programs (65 percent), services for at-risk youth (25 percent), and services for crime victims (10 percent).

The May Revision assumes that net state savings from Prop. 47 in the current fiscal year (2015-16) will total $39.4 million. This figure reflects savings from reduced incarceration offset by certain costs associated with Prop. 47, including costs for state parole and for trial courts. The Governor's current Prop. 47 savings estimate is somewhat higher than the surprisingly low estimate that he released in January: $29.3 million. However, even the Governor's updated savings estimate is substantially *lower* than the most recent projection from the nonpartisan Legislative Analyst's Office (LAO): roughly $130 million.

The Administration's estimate of savings has increased, at least in part, because Prop. 47 is now expected to have a larger impact on incarceration. The May Revision assumes that Prop. 47 will reduce by 5,247 the number of adults incarcerated by the state in 2015-16. This is up by 535 from the 4,712 reduction assumed in the January budget proposal.

The Governor's final Prop. 47 state savings calculation for 2015-16 is due by July 31. It is uncertain whether the Administration will further modify this calculation as part of state budget deliberations.

In addition, the May Revision:

- **Provides $10.8 billion in General Fund support for corrections in 2016-17.** This includes funding for the California Department of Corrections and Rehabilitation (CDCR) and the Board of State and Community Corrections (BSCC). This spending level would be approximately $600 million (5.8 percent) higher than estimated 2015-16 amount.
- **Expands rehabilitation opportunities for adults incarcerated by the state.** The Governor proposes $24.5 million (General Fund) "to expand, enhance, and create programming

opportunities for state prison inmates," according to budget documents. This includes $4 million for the Arts in Corrections program, $3.7 million for substance use disorder treatment, $2.3 million for career technical education, and $2.2 million for cognitive behavioral therapy.

- **Projects that counties will receive $1.3 billion in special fund dollars in 2016-17 to support their role in supervising – in and outside of jails – many adults convicted of certain "low-level" felonies.** Counties receive these funds as part of the 2011 transfer – or "realignment" – of certain public safety responsibilities from the state.

May Revision Maintains Strategy of Pre-Funding Retiree Health Benefits and Increasing Employee Compensation

In recent years the Governor has called for reducing the state's unfunded liability for retiree health care. This liability results from the state not setting aside enough funds to pay for the health benefits accrued by current and future retired state workers. The state faces a $74 billion unfunded liability for the costs of these benefits, and this liability will grow substantially over time if not addressed.

The May Revision continues to advance a strategy for reducing unfunded liability for retiree health care that consists of equal cost-sharing between the employer and employee to pre-fund retiree health benefits; extending the period to qualify for retiree health benefits; and reducing the employer subsidy for these benefits. This strategy, which is reflected in last fall's collective bargaining agreement with professional engineers and in both recent collective bargaining agreements with correctional peace officers and professional scientists, will be used in active contract negotiations with 17 additional bargaining units.

The May Revision also sets aside $500 million ($200 million General Fund) to offset potential employee compensation and benefit cost increases resulting from future collective bargaining agreements.