CALIFORNIA BUDGET PROJECT

Updated July 8, 2013

Final 2013-14 Budget Agreement Signals a New Chapter for California, With More Work to Be Done

On June 27, Governor Jerry Brown signed the 2013-14 California state budget and related legislation. This budget marks a significant turning point in California's fiscal outlook, thanks to additional revenues approved by voters last November as well as gradually improving economic conditions in the state. The 2013-14 budget agreement signals a new chapter for California by expanding Medi-Cal eligibility under federal health care reform, fundamentally restructuring school finance to increase resources for disadvantaged students, and beginning to reinvest in other vital public systems and services. The budget agreement also builds toward future fiscal and economic stability by paying down budgetary debt and maintaining a reserve.

The 2013-14 budget agreement calls for $96.3 billion in General Fund expenditures and total state spending of $145.3 billion, which includes General Fund, special fund, and bond fund dollars. Highlights of this budget agreement include:

- Increasing funding for K-12 schools, community colleges, the University of California, and the California State University;
- Restructuring K-12 school finance with the goal of providing additional dollars to educate disadvantaged students;
- Expanding Medi-Cal eligibility to cover over a million additional low-income Californians;
- Modest improvements and enhancements to a number of services severely cut in recent years, including adult dental care, mental health care, child care and preschool, and CalWORKs;
- Paying down budgetary debt as part of a multiyear effort to reduce it from $35 billion in 2010-11 to less than $5 billion by 2016-17; and,
- Maintaining a $1.1 billion reserve.

California's leaders have work left to be done. Poverty and long-term unemployment are still high in the wake of the Great Recession, while the social safety net and critical employment services remain weakened by recent years' spending cuts. Still, the 2013-14 budget begins to lay the foundation for stronger communities and broadly shared prosperity.

The following sections review key provisions of the budget agreement and their implications for Californians. The CBP will release additional commentary and analysis in the coming weeks. Please check the CBP's website (www.cbp.org) for the latest information and updates.

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Budget Agreement Maintains the Minimum Funding Level for Schools and Community Colleges in the May Revision

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 2013-14 budget agreement assumes a Proposition 98 funding level of $56.5 billion for K-14 education programs in 2012-13 and $55.3 billion in 2013-14. These are approximately the same levels included in the Governor's May Revision, but significantly above the $47.2 billion Proposition 98 funding level in 2011-12. Specifically, the budget agreement:

- **Provides $4.3 billion over two years to partially restore previously deferred payments to schools and community colleges.** In 2011-12, $10.4 billion in annual Proposition 98 payments to K-14 schools (21 percent of the total Proposition 98 funding level) were delayed until 2012-13. Of these deferred payments, the budget agreement repays schools and community colleges $4.0 billion in 2012-13 and $272 million in 2013-14. Outstanding payment deferrals at the end of 2013-14 – that is, the amount the state still owes schools and community colleges – will be $6.2 billion under the budget agreement.

- **Provides $2.1 billion in 2013-14 Proposition 98 funds to begin implementation of the Local Control Funding Formula (LCFF).** The LCFF restructures the state's education finance system by providing all school districts with a base grant per student, adjusted to reflect the number of students at various grade levels, as well as additional resources to reflect the higher costs of educating English learners, students from low-income families, and foster youth.

- **Provides $1.25 billion in one-time funding to support implementation of the Common Core State Standards (CCSS), $250 million more than was included in the Governor's May Revision.** In August 2010, the State Board of Education adopted CCSS for California's K-12 schools. The budget agreement provides school districts and county offices of education (COEs) with CCSS implementation funding of $1.0 billion in 2012-13 Proposition 98 dollars and $250 million in 2013-14 Proposition 98 dollars. These funds are provided on a per pupil basis and may be used at any time during 2013-14 or 2014-15. The budget agreement requires school districts and COEs to:

    - Use CCSS implementation dollars for specific purposes, including instructional materials and professional development for teachers, administrators, and other staff involved in the direct instruction of students;
    - Adopt a plan delineating how CCSS implementation dollars will be spent; and
    - Report by July 1, 2015 how CCSS implementation dollars were spent.

- **Provides $428 million in Proposition 98 funds – from Proposition 39 revenue – for energy efficiency programs in schools and community colleges.** Approved by voters in November 2012, Proposition 39 (the California Clean Energy Jobs Act) provides for the transfer of up to $550 million annually from the General Fund to a Clean Energy Job Creation Fund. The 2013-14 budget agreement provides $381 million of these funds to the California Department of Education for allocation to school districts and COEs and $47 million to the California Community College Chancellor's Office for allocation to community college districts. Of the dollars provided to school districts and COEs, 85 percent must be allocated based on average daily attendance and 15 percent based on students eligible for free and reduced-price meals. In addition, the budget agreement provides $28 million in Proposition 98 funds – also from Proposition 39 revenue – to the California Energy Commission to support low-interest and no-interest revolving loans for eligible energy projects at, and technical assistance for, schools and community colleges.

- **Provides $250 million in one-time funding to establish the California Career Pathways Trust (CCPT).** CCPT funds will be allocated to schools and community colleges through competitive grants. These dollars would fund career pathway programs that aim to align educational activities with regional economies, such as by establishing regional partnerships between K-14 education and business entities. To qualify for a CCPT grant, recipients must provide their own funding, and obtain funding from partners, to support ongoing program costs. The CCPT grants can be used at any time from 2013-14 through 2015-16.

Budget Agreement Includes the Local Control Funding Formula, But Compromises on Revenue for Disadvantaged Students

In January, Governor Brown proposed to restructure the state's K-12 education finance system through a Local Control Funding Formula (LCFF). The budget agreement maintains the main components of the Governor's original proposal: eliminating the majority of programs currently earmarked for specific purposes (so-called "categorical" programs), consolidating that funding with state general purpose revenues, and establishing a new education funding formula designed to provide additional resources for disadvantaged students. The Governor's original LCFF proposal created three grants weighted to reflect the costs of educating different students: a base grant per student for all school districts, adjusted to reflect students' grade levels; a supplemental grant per student based on a district's unduplicated number of English learners and students from low-income families; and a concentration grant per student for districts based on the share of disadvantaged students above a specific threshold (set at 50 percent in the original proposal). The budget agreement maintains this basic LCFF structure, but changes the formulas used to calculate the supplemental and concentration grants and extends the estimated amount of time to fully implement the LCFF from seven to eight years. Under the budget agreement, the LCFF:

- Increases the average target base grant by $537 per student, from $6,772 per student in the Governor's original proposal to $7,309 per student (this refers to the average of four different target base grants that the LCFF designates based on students' grade levels);

- Reduces the supplemental grant from 35 percent of the base grant to 20 percent;

- Increases the concentration grant from 35 percent of the base grant to 50 percent;

- Increases the threshold at which school districts qualify for the concentration grant, with disadvantaged students having to account for at least 55 percent of district enrollment – up from the original threshold of 50 percent; and

- Eliminates time limits for supplemental and concentration grant funding for English learners.

The budget agreement includes payments to school districts whose funding under the LCFF would not be sufficient to restore their funding to 2007-08 levels. These "economic recovery target" (ERT) payments will only be provided to school districts that receive a level of funding per student that is below the top 10 percent of school districts statewide. After the LCFF is fully implemented, districts will receive ERT payments in perpetuity.

In sum, the budget agreement changes the share of *total* LCFF dollars allocated to each grant compared to the May Revision. Under the May Revision, 80 percent of LCFF dollars would have gone toward base grants, 16 percent to supplemental grants, and 4 percent to concentration grants. Under the budget agreement, 84 percent of LCFF dollars will be allocated to base grants, 10 percent to supplemental grants, and 6 percent to concentration grants.

The budget agreement also specifies several accountability provisions for the LCFF. These include the following requirements:

- The State Board of Education (SBE) must adopt regulations by January 31, 2014 that govern the spending of LCFF dollars for disadvantaged students.

- The SBE must adopt a template for local control and accountability plans (LCAPs) by March 31, 2014.

- School districts and COEs must adopt LCAPs, using the SBE template, by July 1, 2014 that include annual goals for all students and specific actions that will be taken to achieve these goals.

- Each school district must present the LCAP, prior to its adoption, to a parent advisory committee and an English learner parent advisory committee for review and comment and must hold at least one public hearing regarding the specific actions and expenditures proposed to be included in the LCAP.

- School districts and COEs must update their LCAPs by July 1, 2015 with a description of how spending will serve disadvantaged students.

Budget Establishes Middle Class Scholarship Program and Increases Overall Higher Education Spending

Beginning in 2014-15, the Middle Class Scholarship Program will provide scholarships at the University of California (UC) and the California State University (CSU) for some in-state students who come from families with incomes of between $100,000 and $150,000. Upon full implementation in 2017-18, eligible UC and CSU students will receive tuition discounts of between 10 and 40 percent, depending on family income. The budget agreement caps the total annual cost of the program at $305 million.

The budget agreement also increases General Fund spending by more than $250 million each for the UC and the CSU in 2013-14. However, state support for the UC and CSU will remain significantly below 2007-08 levels. Also, the current budget agreement does not restore reductions that last year's budget agreement made to maximum Cal Grant awards for certain categories of students. These reduced award levels will be carried forward to 2013-14. Cal Grants help hundreds of thousands of in-state students from lower-income families pay for higher education each year.

In signing the 2013-14 budget, the Governor vetoed provisions that established enrollment targets for the UC and the CSU as well as provisions that earmarked a portion of UC and CSU funds for specific programs.

Policymakers Require School Districts to Maintain Adult Education Spending for the Next Two Years

In his May Revision, the Governor issued an adult education proposal that put on hold for two years his plan – introduced in January – to shift significant responsibility and funding for adult education away from K-12 school districts, where adult schools have traditionally resided, to community colleges. Consistent with the provisions of the May Revision, the budget agreement brings some measure of stability to adult education programs by protecting them from cuts for the next two years; cuts made in prior years have led to a decline in adult education spending of well over 50 percent since 2007-08.

Under the 2013-14 budget agreement, districts that currently receive state funding for adult education will be required to maintain 2012-13 spending levels for these programs through 2014-15. This is the year prior to when a transition to a regional partnerships system – comprised of K-12 and community college districts and other adult education providers – is slated to be implemented. The budget agreement provides $25 million in 2013-14 for two-year planning and implementation grants to help districts form these regional partnerships and develop plans to integrate existing programs into the new partnership program.

Budget Reflects Major Expansion of Medi-Cal, Shifts Dollars Currently Used for Indigent Health Care From Counties to the State

Medi-Cal – the state's Medicaid Program – provides health coverage to more than 8 million low-income Californians, primarily children, youth, and women. This number is expected to rise substantially beginning in January 2014 due to a major program expansion adopted by state policymakers. As authorized by federal health care reform, California will extend Medi-Cal coverage to parents and childless adults who are currently excluded from the program and whose incomes do not exceed 138 percent of the federal poverty line ($15,856 for an individual in 2013). About 1.4 million Californians under age 65 will become eligible for Medi-Cal under the expansion, with roughly 500,000 to 800,000 of these newly eligible residents expected to enroll during 2014. The federal government will pay the full cost of the expansion for the first three years, phasing down to a still-high 90 percent of the cost by 2020. The budget agreement assumes California will receive $1.5 billion in federal funds in 2013-14 to support the expansion.

The budget agreement also redirects – from counties to the state – funding that counties currently use to provide health care to low-income, uninsured ("medically indigent") residents. Counties receive these dollars as part of the state-to-county transfer – or "realignment" – of services that was implemented in 1991. The budget deal reflects the Governor's assertion that counties will no longer need all of these 1991 realignment dollars to support their health care safety nets as many medically indigent adults newly enroll in Medi-Cal under the expansion. Up to $300 million will be shifted from counties in 2013-14. The amount shifted is likely to grow substantially in subsequent years. However, the size of each year's shift will depend on various factors, including which of two formulas each county initially adopts to determine how much of its health care "savings" must be shared with the state each year. (Counties that participate in the County Medical Services Program will not have an option; they must use a specified formula.)

Under either formula, the state would claim the majority of savings – either 80 percent or 60 percent – with counties retaining the remainder. The state's share of these 1991 realignment revenues would be used to pay for CalWORKs grant costs that would otherwise be funded with General Fund dollars, thereby generating substantial ongoing state savings in the CalWORKs Program. It is uncertain whether the formulas established by the budget agreement will leave counties with sufficient funds to provide health care for the 3 to 4 million Californians who are projected to lack coverage even after full implementation of health care reform.

Budget Agreement Restores Some Medi-Cal Dental Services for Adults and Boosts Mental Health Funding, but Assumes a Deep Cut to Medi-Cal Provider Rates

In addition to expanding Medi-Cal, the budget agreement increases the state's investment in two key health policy areas: dental care for low-income adults and mental health services. Specifically, the budget:

- **Restores selected dental services for adults in Medi-Cal effective May 1, 2014 – nearly four years after state policymakers eliminated adult dental care in the Medi-Cal Program.** Medi-Cal will cover basic exams and fluoride treatments, crowns, root canal therapy, complete dentures, and certain other services. Restoring these services for adults is estimated to cost $33.8 million ($16.9 million General Fund) in 2013-14. Annual costs are estimated to be $211.3 million ($85.6 million General Fund).

- **Provides $206.2 million ($142.5 million General Fund) to boost local mental health services and improve outcomes for individuals with mental health disorders.** This includes expanding access to early intervention and treatment services, adding at least 25 mobile crisis-support teams and 2,000 crisis stabilization and residential treatment beds, and adding at least 600 triage personnel to help provide appropriate services to individuals with mental health disorders.

In contrast, the budget agreement leaves in place the Medi-Cal provider rate cut enacted in 2011, which has not yet taken effect due to litigation. A federal appeals court has ruled in the state's favor, and the Administration is likely to implement the cut later this year unless the US Supreme Court grants a stay while health provider associations prepare an appeal. The cut will be applied retroactively to June 2011 and means that doctors and other health care providers who participate in Medi-Cal will face payment cuts of 15 percent or more at the same time the state is expanding the program in early 2014.

Budget Agreement Reinstates a Tax on Medi-Cal Managed Care Plans, Assumes Extension of Current Fee on Hospitals

The budget agreement temporarily reinstates a tax on Medi-Cal managed care plans that expired last year. The new tax is retroactive to July 1, 2012 and will remain in effect through June 30, 2016. For 2012-13, the tax equals the gross premiums tax rate of 2.35 percent. For 2013-14 to 2015-16, the tax equals the state sales and use tax rate of 3.9375 percent. The tax proceeds will be used to draw down matching federal dollars. The total revenues (tax proceeds plus federal funds) will be used for two purposes: to reimburse the managed care plans for the cost of the tax – that is, to make the plans whole – and to offset state General Fund costs for health care services. Replacing General Fund dollars with revenues attributable to the new tax will result in estimated state savings of $128.1 million in 2012-13 and $342.9 million in 2013-14.

The budget agreement also assumes $310 million in General Fund savings in 2013-14 due to extending the current "quality assurance fee" on hospitals, which is set to expire on January 1, 2014. A bill that would extend the fee through December 30, 2015 – SB 239 (Hernandez) – was not included in the budget package, but is currently moving through the Legislature as a policy bill.

Budget Funds Early Engagement Strategies, Applies Child Poverty Adjustment to CalWORKs Grant

The CalWORKs Program provides modest cash assistance for 1.1 million low-income children while helping parents overcome barriers to employment and find jobs. State policymakers made deep cuts to the program in recent years, including substantially reducing cash aid for families. Last year, the Governor and state legislators enacted a significant program change: a new 24-month limit on the amount of time CalWORKs parents can access the full array of welfare-to-work activities available under state law before having to meet less flexible federal work participation requirements as a condition of receiving cash aid. As a result of this change, CalWORKs participants – whose time clocks under the new limit began "ticking" on January 1, 2013 – face a still-challenging job market with less time to access resources for securing long-term employment.

The 2013-14 budget agreement includes an increase of $142.8 million to support counties in providing CalWORKs employment services consistent with the new time limit as well as other changes to the program structure made last year. The budget also allocates roughly $48 million in 2013-14 to help counties implement "early engagement strategies" to maximize CalWORKs parents' limited time to participate in state-allowed welfare-to-work activities and successfully transition into the workforce.

In addition, the budget agreement:

- Adopts a "child poverty adjustment" to the CalWORKs grant, to be funded with special fund growth dollars from the 1991 realignment. A 5 percent increase to the maximum grant will occur March 1, 2014, for an estimated cost of $51 million in 2013-14. In 2014-15 and beyond, additional increases could be made based on the level of growth dollars available. The increased grant amount for a given year would become the base level for the following year. If growth funds in a given year fall below the base level, the amount needed to fully fund the base would come out of the General Fund.

- Increases the vehicle asset limit used in CalWORKs eligibility determinations, effective January 1, 2014, to $9,500 in equity value – from the current amount of $4,650 – with annual inflation adjustments.

The budget agreement's changes to CalWORKs are modest compared to the significant funding restorations and improvements proposed by the Assembly, but are still a step in the right direction. The child poverty adjustment will increase the maximum CalWORKs grant for a family of three in a high-cost county from 39 percent of the federal poverty line to an estimated 41 percent of the poverty line in 2013-14. While cash grants for most families will remain below the "deep poverty" cut-off of 50 percent, this adjustment lays the groundwork for incremental increases in future years. In addition, the increase in the vehicle asset limit addresses the fact that many CalWORKs participants need a reliable car in order to get to and from work.

Budget Agreement Funds Additional Child Care and Preschool Slots, Backfills Federal Sequestration Cuts

California's subsidized child care and preschool programs help prepare children for school and provide affordable supervision so that low-income parents can find jobs and stay employed. State policymakers have cut annual funding for these programs by more than $900 million since 2007-08, resulting in the elimination of more than 110,000 child care and preschool slots. Policymakers in recent years also significantly lowered the income eligibility limit for child care and cut payments to license-exempt child care providers.

Although the budget as passed by the Legislature provided $30 million for new slots in the state preschool program, the Governor used his line-item veto authority to reduce this amount to $25 million. In addition, $10 million in unspent child care funds from the 2012-13 fiscal year will be used to provide new slots for General Child Care, the Alternative Payment Program, and Migrant Child Care in 2013-14. The budget agreement also makes up for federal sequestration cuts to child care by allocating an estimated $15.9 million from the General Fund to backfill federal funding reductions.

Budget Does Not Restore State Cost-of-Living Adjustment for SSI/SSP, Reflects IHSS Legal Settlement With 8 Percent Reduction in Authorized Hours of Care

Supplemental Security Income/State Supplementary Payment (SSI/SSP) grants help nearly 1.3 million low-income seniors and people with disabilities to afford food and other basic necessities. Monthly grants for couples and for individuals were reduced to federal minimums in 2009 and 2011, respectively. The maximum SSI/SSP grant for individuals dropped below the federal poverty line in 2009 – and remains 10 percent below poverty. The Assembly's version of the budget would have reinstated the annual state cost-of-living adjustment (COLA) for SSI/SSP grants, which was eliminated in 2009. However, the 2013-14 budget agreement does not adopt this change.

Many seniors and people with disabilities in California also rely on the In-Home Supportive Services (IHSS) Program, which helps more than 400,000 low-income individuals remain safely in their own homes, preventing the need for more costly out-of-home care. The 2013-14 budget agreement reflects a March 2013 legal settlement among IHSS beneficiaries, labor organizations, and the state that averted a permanent 20 percent reduction in authorized hours. Under this settlement, a smaller across-the-board cut of 8 percent will be applied to the total hours of care each IHSS consumer is authorized to receive. Beginning in 2014-15, the reduction will scale back to 7 percent. Some or all authorized hours could be restored to recipients as early as 2015 if the state secures additional federal funding.

Budget Agreement Phases Out California's Enterprise Zone Program, Creates a New Package of Economic Development Incentives

The budget agreement phases out the state's controversial Enterprise Zone (EZ) Program in its current form and replaces it with changes to the state's tax system that establish a new package of economic development incentives. Specifically, the budget agreement:

- **Retains current EZ designations but modifies them to more effectively target the most economically distressed areas of the state.** Current EZ designations will remain intact for the 40 existing EZs, plus two recently expired zones – Antelope Valley and Watsonville – but incentives will also be available for use in census tracts throughout the state that rank in the top 25 percent in both unemployment and poverty rate. Further, census tracts with low unemployment and low poverty rates will be removed from the existing EZs, ensuring that the hiring tax credit truly is targeted to businesses located in the state's most economically distressed areas. Lastly, the seven existing Local Area Military Base Recovery Areas (LAMBRAs) will be preserved and eligible for incentives, as well.

- **Alters key elements of the EZ hiring credit to create and retain jobs for disadvantaged individuals.** The budget agreement also makes major changes to the hiring tax credit to improve performance. These changes include:

    - Requiring businesses to create new *jobs* – not just make new *hires* – as a condition of claiming hiring credits.

    - Discontinuing retroactive vouchering, whereby credits are awarded for hires made in past years.

    - Maintaining the credit for a particular employee at a constant level over a five-year period, instead of having the credit decrease over time. This change removes the incentive and reward for employers that "churn" their workforces.

    - Ensuring that companies that take the hiring credit pay employees a living wage. Specifically, the budget agreement increases the amount of qualified wages from *up to* 150 percent of minimum wage – currently $12 per hour – to *between* 150 percent and 350 percent of minimum wage. This currently is between $12 and $28 per hour. The credit is only available for qualified wages paid to employees who work an average of at least 35 hours per week. In five pilot areas that would be designated by the Governor's Office of Business and Economic Development (GO-Biz), qualified wages will be set between $10 an hour and 350 percent of minimum wage to reflect working conditions in areas with average wages less than the statewide average.

    - Targeting the hiring tax credit to five categories of individuals, which is much narrower than the 10 groups included in current eligibility requirements. The targeted groups will include individuals who have been previously unemployed for six months, recipients of the Earned Income Tax Credit, recipients of CalWORKs or General Assistance, unemployed veterans, and ex-offenders.

- **Creates a manufacturing equipment sales and use tax (SUT) exemption.** The SUT exemption will eliminate the California portion of sales and use tax for basic manufacturing and research and development (R&D) purchases for use within manufacturing and biotech industries. This exemption will be available *statewide* – rather than just within certain geographic areas. The maximum amount of purchases eligible for the SUT exemption statewide is not to exceed $200 million annually.

- **Establishes a business incentive fund to retain and attract businesses to California.** The budget agreement establishes a new fund that will be administered by GO-Biz for the purpose of negotiating business tax credits in exchange for investments and employment expansion in California. The budget agreement also creates the California Competes Tax Credit Committee – consisting of representatives from the Treasurer's Office, Department of Finance, and GO-Biz, and an appointee from both the Senate and Assembly – which will provide final approval for GO-Biz's allocation of tax incentives. The fund will be limited to $30 million in 2013-14 increasing to $200 million annually in 2015-16 through 2018-19.

The budget agreement includes a number of provisions intended to ensure that the new economic development package is effective, transparent, and available to small businesses. First, the hiring tax credit, the SUT exemption, and the GO-Biz fund require annual evaluations to ensure that program administrators, policymakers, and the public are able to track program usage, and they each contain provisions that require businesses to return money to the state if certain terms are not met. Second, the budget agreement creates clear benchmarks to ensure that small businesses – defined as having less than $2 million in gross receipts in the previous year – benefit from the economic package. Specifically, 25 percent of the hiring tax credit will be reserved for small businesses, and industry restrictions on the hiring tax credit will be lifted for small businesses, as well. In addition, 25 percent of the funds allocated to the GO-Biz will also be reserved for small businesses. Lastly, the budget agreement includes sunset dates for the programs, a provision that does not exist within the existing EZ Program.