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First Look

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Enacted Budget Includes a Number of Improvements, Reflects Ongoing Uncertainty About Federal Commitments

On June 27, Governor Brown signed the 2017-18 state budget bill. This year's budget agreement includes a number of improvements over earlier proposals, though the overall scope of state investments remains constrained by uncertainty about potential federal policy changes. The 2017-18 budget package:

- Expands the California Earned Income Tax Credit (CalEITC) to well over 1 million additional families by expanding the credit to the self-employed and increasing the income eligibility limits.
- Reflects an agreement between the Governor and legislative leaders over how to spend Proposition 56 tobacco tax revenues for Medi-Cal, with this funding going to supplemental payments for Medi-Cal providers and also to covering ordinary spending growth in the program.
- Continues a multiyear reinvestment in subsidized child care and preschool that the Governor had proposed to delay in January. This includes increasing reimbursement rates for providers and adding full-day preschool slots. The enacted budget also increases access to subsidized care by raising income eligibility limits and establishing a 12-month eligibility period.
- Requires counties to pay a larger share of In-Home Supportive Services (IHSS) costs, but includes temporary funding and other provisions to mitigate the impact of this cost-shift.
- Mitigates a reduction in core funding for counties' delivery of CalWORKs welfare-to-work services based on an expected decline in caseload and makes other small additional investments in welfare-to-work services.
- Continues to increase funding for K-14 education as required by the Prop. 98 guarantee.
- Includes dedicated resources to respond to federal action on immigration, including support for people seeking help with naturalization, deportation defense, and securing legal immigration status.

The budget package sets aside $3.6 billion as constitutionally required by Prop. 2 (2014), with half deposited in the state's rainy day fund and half used to pay down state budgetary debt. The budget package also includes a supplemental $6 billion payment for the California Public Employees' Retirement System (CalPERS), using funds borrowed from a state short-term investments account. Other notable elements include a significant restructuring of the state Board of Equalization as well as a transportation package agreed to by state leaders earlier this year, which will invest more than $50 billion over 10 years in state and local infrastructure through increases in fuel and vehicle-related taxes and fees.

The budget package makes no increases in basic income support for low-income seniors and people with disabilities (SSI/SSP) and lacks any proposals to address California's affordable housing crisis. Please check the Budget Center's website (calbudgetcenter.org) for our latest commentary and analysis.

Budget Package Projects Increase in Revenues, Continues to Boost State Reserves

The budget package projects General Fund revenues of $127.7 billion for 2017-18. This represents an increase of $6.1 billion over the current fiscal year (2016-17) and also reflects a modestly improved revenue picture compared to the Governor's January projection of $125.2 billion for 2017-18 (an increase of $2.5 billion).

Of the $127.7 billion in projected General Fund revenues, $1.8 billion is taken "off the top" and transferred to the Budget Stabilization Account (BSA), the state's constitutional "rainy day fund." California voters revised the rules that apply to the BSA by passing Proposition 2 in November 2014. Prop. 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 enacted budget projects that the BSA will total $6.7 billion by the end of the current fiscal year (2016-17). Based on projected revenues for 2017-18, Prop. 2 constitutionally requires the state to deposit an additional $1.8 billion into the BSA (as well as set aside $1.8 billion for repaying budgetary debt), bringing the total amount in the BSA to $8.5 billion by the end of 2017-18.

The BSA is not California's only reserve fund. Each year, the state deposits additional General Fund revenues into a "Special Fund for Economic Uncertainties" (SFEU). The enacted budget includes $1.4 billion for this fund, bringing state reserves to a total of $9.9 billion (BSA + SFEU) by the end of 2017-18.

Budget Agreement Expands the CalEITC

The California Earned Income Tax Credit (CalEITC) is a refundable state tax credit that state policymakers established in June 2015. This credit, modeled after the *federal* EITC, helps working families who earn very little from their jobs to better afford basic necessities. Around 350,000 families benefited from the CalEITC in tax year 2016 – the second year that the credit was available. Single parents with multiple qualifying children received an average of roughly $1,000 from the CalEITC, while workers without qualifying children received an average of about $100.

The 2017-18 budget agreement significantly expands the CalEITC so that well over 1 million *additional* families could benefit from the credit beginning in tax year 2017. Specifically, the budget agreement:

- **Allows low-earning self-employed workers to be eligible for the credit.** Currently, the CalEITC is the only EITC in the nation that excludes many low-earning, self-employed workers. This exclusion undermines a fundamental purpose of the EITC: to encourage and reward work. The budget deal ends this exclusion, bringing the state credit into better alignment with the *federal* credit. This change means that independent contractors and small business owners who meet all other eligibility criteria will be able to benefit from the CalEITC beginning in tax year 2017.
- **Raises the income limits to qualify for the credit.** Many workers who struggle to get by are not eligible for the CalEITC because the income limits to qualify for the credit are extremely low. Parents are not eligible for the credit unless their annual earnings are less than around $10,000 to $14,000, depending on the number of children they are supporting. Workers without qualifying children are not eligible unless they earn under about $6,700 annually. These income limits are so low that full-time minimum wage workers earn *too much* to qualify for the credit, even though they typically earn too little to make ends meet. The 2017-18 budget agreement raises the income limits to qualify for the CalEITC beginning in tax year 2017, thereby allowing many more low-earning workers to benefit from the credit. For parents with qualifying children, the limit will increase to just over $22,000 – roughly equivalent to a full-time, year-round minimum wage worker's annual earnings. The new limit for parents will also be closer to the threshold to qualify for the *federal* EITC, which ranges from about $39,600 to about $48,300 for single parents, depending on the number of children they are supporting. For workers without qualifying children, the CalEITC limit will increase to about $15,000 – roughly equal to the threshold for these workers to qualify for the federal EITC.
- **Maintains support for CalEITC promotion.** Awareness of the CalEITC appears to be low, and many people who were eligible for the credit during its first two years appear to have missed out on it. Lower-than-expected take-up of the CalEITC likely reflects the fact that the majority of workers who are eligible for the credit are not required to file state income taxes due to their very low incomes. In other words, many eligible workers may not realize that they can receive a tax refund even if they do not owe state income taxes. For this reason, promoting the CalEITC is critical to maximizing the credit's success. The 2017-18 budget includes $2 million to maintain a grant program created last year that is designed to help communities expand their efforts to promote the CalEITC. The budget also provides about $5.8 million to the Franchise Tax Board to administer the CalEITC, including the processing and auditing of tax returns that claim the credit.

Budget Package Updates Eligibility Guidelines and Continues Multiyear Investment in Early Care and Education

The 2017-18 budget package continues implementation of the multiyear investment in California's subsidized child care and development system, as included in the 2016-17 budget agreement. The budget package also takes an important step forward in updating income eligibility guidelines for subsidized programs, which have not been updated in a decade. Specifically, the budget package:

- **Provides $160.3 million to increase the reimbursement rate for providers that contract directly with the state.** The budget increases by 5 percent the Standard Reimbursement Rate (SRR), the payment rate for providers contracting with the state ($43.7 million Prop. 98, $23.9 million non-Prop. 98 General Fund). This increase takes effect July 1, 2017, and reflects the second half of a 10 percent increase included in the 2016-17 budget agreement. In addition, the 2017-18 budget increases the SRR by *an additional* 6 percent, also effective July 1, 2017 ($60.7 million Prop. 98, $32 million non-Prop. 98 General Fund).
- **Provides $40.6 million General Fund to update the payment rate for voucher-based providers.** Families can access subsidized care by using a voucher to select a child care provider of their choice. The value of these vouchers is based on the state's Regional Market Rate (RMR) Survey, which is conducted on a periodic basis. The budget package increases the value of vouchers by updating rates to the 75th percentile of the 2016 RMR Survey, effective January 1, 2018.
- **Provides $25 million General Fund to update income eligibility limits and implement a 12-month eligibility period.** The budget agreement updates income eligibility limits using the most current state data on family incomes. The budget also establishes a 12-month eligibility period, where families remain eligible regardless of changes in income or need, as long as family income does not exceed 85 percent of state median income. These changes bring California into compliance with the federal Child Care and Development Block Grant rules and take effect July 1, 2018.
- **Provides $15.5 million General Fund to create a "child care bridge" for children in foster care.** In participating counties, the Emergency Child Care Bridge Program for Foster Children will help foster care families find and pay for short-term child care services, effective January 1, 2018.
- **Provides $7.9 million Prop. 98 General Fund to increase the number of slots in the state preschool program.** The budget package adds 2,959 full-day state preschool slots beginning March 1, 2018, as stipulated in the original multiyear plan in the 2016-17 budget agreement.

Budget Package Boosts the Minimum Funding Level for Schools and Community Colleges

Approved by voters in 1988, Prop. 98 constitutionally guarantees a minimum level of funding for K-12 schools, community colleges, and the state preschool program. The 2017-18 budget agreement assumes the same Prop. 98 funding levels for 2015-16 ($69.1 billion) and 2016-17 ($71.4 billion) as the May Revision, and a 2017-18 Prop. 98 funding level of $74.5 billion, slightly lower ($77 million) than the May Revision. The Prop. 98 guarantee tends to reflect changes in state General Fund revenues, and while the May Revision's estimates of 2015-16 revenues were up relative to assumptions in January's budget proposal, the May Revision's 2015-16 Prop. 98 funding level was actually *greater than* the minimum funding guarantee based on the May revenue estimates. Because calculations of the Prop. 98 guarantee are usually based on prior-year funding levels, the 2015-16 Prop. 98 funding level in the budget agreement leads to higher Prop. 98 funding levels in 2016-17 and 2017-18 than the minimum funding guarantee otherwise would have required.

The budget agreement also includes two provisions that affect the Prop. 98 guarantee for 2016-17. The first provision suspends an additional payment that is statutorily required in years when the Prop. 98 guarantee would grow less quickly than the rest of the state budget; this reduces the 2016-17 Prop. 98 guarantee by $405 million from $71.3 billion to $70.9 billion. The second provision allocates up to $514 million in 2016-17 Prop. 98 spending as a settle-up payment for prior-year obligations if Prop. 98 spending exceeds the minimum guarantee in that year. Because actual 2016-17 Prop. 98 spending is $71.9 billion, $993 million *above* the minimum funding guarantee, the new budget agreement allocates the full $514 million as a settle-up payment, resulting in a 2016-17 Prop. 98 funding level of $71.4 billion.

Budget Increases Support for the Local Control Funding Formula (LCFF) and Other K-12 Spending

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. Consistent with proposals made in the January budget and the May Revision, the budget agreement increases funding for the LCFF – the state's K-12 education funding formula – and pays off outstanding obligations to school districts. Specifically, the budget agreement:

- **Provides $1.4 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 increase in LCFF funding may reduce the amount of time it takes for its full implementation, which depends on funding 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 2017-18 LCFF funding level in the budget agreement would bring the LCFF formula "to 97 percent of full implementation."

- **Provides $877 million in one-time funding 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 an additional $50 million, for a total of $600 million, in ongoing funding for the After School Education and Safety (ASES) Program.** The boost in ASES' funding will help cover costs for implementing new minimum wage obligations.
- **Provides $30 million in one-time funding for teacher workforce programs.** The budget agreement provides $25 million, to be available through 2021-22, for a second cohort of school employees to obtain their teaching credential through the Classified School Employee Teacher Credentialing Program. The budget agreement also provides $5 million in competitive grants, to be available through 2019-20, for a newly established Bilingual Teacher Professional Development Program to help California meet the demand for bilingual teachers needed to implement programs authorized by voter approval of Prop. 58 last November.
- **Provides $10 million in one-time funding to support refugee students.** The budget agreement requires the Department of Social Services to allocate these dollars between 2017-18 and 2019-20 to school districts that are impacted by significant numbers of refugee students.
- **Maintains cost-of-living adjustments (COLAs) for non-LCFF programs.** Consistent with the May Revision, the budget agreement provides an additional $3.2 million to fund a 1.56 percent COLA, up from the 1.48 percent COLA proposed in the January budget, for several categorical programs that remain outside of the LCFF. These include special education, child nutrition, and American Indian Education Centers.
- **Includes provisions to increase accountability for general obligation (GO) school facilities bond funds approved by voters last November.** Prop. 51 authorized $7 billion in state GO bonds for K-12 school facilities. However, the Governor's May Revision stated that the Administration would only support the expenditure of Prop. 51 dollars once measures were taken "to ensure that taxpayers' dollars are spent appropriately." The budget agreement includes trailer bill language (AB 99), proposed by the Governor, which requires audits of financial reports that school districts will be required to submit for school facilities projects that began after April 1, 2017.

Budget Agreement Increases Funding for California Community College Operations and Other Purposes

A portion of Prop. 98 funding supports California's community colleges (CCCs), which help prepare approximately 2.4 million full-time students to transfer to four-year institutions as well as obtain training and skills for immediate employment. The 2017-18 budget agreement increases funding for CCC operating expenses and general-purpose apportionments. Specifically, the budget:

- **Boosts funding for CCC operating expenses by $183.6 million, $23.6 million above the May Revision.** The budget agreement provides funding for the CCCs to pay for increased expenses in areas such as employee benefits, facilities, and professional development.
- **Maintains COLA for apportionments.** Consistent with the May Revision, the budget agreement provides $97.6 million to fund a 1.56 percent COLA for apportionments, up from 1.48 percent as proposed in the Governor's January budget.
- **Provides $76.9 million in one-time funding for deferred maintenance and other CCC expenses.** The budget agreement provides funding for CCCs to pay for facilities and other items including deferred maintenance, instructional equipment, and certain water conservation projects.
- **Increases enrollment growth funding.** The budget agreement maintains the May Revision proposal to provide $57.8 million in 2017-18 to fund a projected 1 percent increase in enrollment growth. The budget agreement also reduces funding by $33 million to reflect unused dollars allocated for 2015-16 enrollment growth.
- **Increases financial aid funding for CCC students by $50 million.** The budget agreement provides $25 million for a newly established Community College Completion Grant Program and an additional $25 million for the Full-Time Student Success Grant program. Completion grants of up to $2,000 will be awarded to students who fulfill a set of requirements, including having received a Full-Time Student Success Grant and maintaining at least a 2.0 grade point average.

Consistent with the May Revision, the budget agreement provides CCCs with $150 million in one-time funding for grants to develop and implement the Guided Pathways Grant Program, an institution-wide approach to supporting student success.

Budget Agreement Increases Higher Education Funding and Requires Increased Transparency From the UC

The 2017-18 budget agreement increases funding for the California State University (CSU) and University of California (UC), but makes a piece of funding for the UC contingent on certain requirements. Specifically, the new spending plan:

- **Increases funding for the CSU by $182.2 million.** In addition to the $162.2 million in increased ongoing funding included in the Governor's January budget proposal, the enacted budget includes $20 million to support an additional 2,487 full-time California resident students compared to the 2016-17 academic year. The budget agreement also provides $20 million in one-time funding to support several CSU programs: $12.5 million for the Graduation Initiative, $3 million for the San Bernardino Palm Desert Campus, $2.5 million to support "hunger free" campuses, and $2 million for equal employment opportunity programs.
- **Increases funding for the UC by $136.5 million, but conditions more than one-third of this boost on the University demonstrating effort to satisfy several expectations.** In addition to $131.2 million in increased funding in the Governor's January budget proposal, the spending plan includes $5 million to support an additional 500 graduate students in 2017-18 compared to the 2016-17 academic year. However, the budget agreement withholds $50 million of this funding, which will be released only if the UC demonstrates – by May 1, 2018 – that it has made a good faith effort to implement: 1) recommendations made by the State Auditor, who identified a number of concerns with UC budgeting practices, 2) a more transparent budgeting process, and 3) a transfer policy at all of its campuses, except for UC-San Francisco and UC-Merced, which aims to ensure that at least one out of every two entering freshman is a transfer student beginning in the 2018-19 academic year.

The budget agreement increases funding for the California Student Aid Commission (CSAC). This includes shifting an additional $117.7 million in federal Temporary Assistance for Needy Families (TANF) funds to support Cal Grants, which offsets General Fund costs for Cal Grants by the same amount. In addition, the budget package:

- **Provides $96 million to maintain the Middle Class Scholarship Program (MCSP).** The Governor proposed to phase out the MCSP in both his January budget proposal and the May Revision. The budget package rejects the Governor's proposal, but reduces funding for the MCSP by $21 million.
- **Provides $48.9 million for the CSAC to pay for higher Cal Grant costs due to recently adopted tuition increases at the CSU and the UC.** The budget package boosts funding to

cover increased Cal Grant costs – $28 million for CSU students and $20.9 million for UC students.

- **Provides an additional $8 million to maintain Cal Grant funding for new students attending private institutions accredited by the Western Association of Schools and Colleges.** The budget agreement maintains the maximum $9,084 Cal Grant award for new students at private nonprofit and for-profit accredited institutions.

Budget Package Uses $546 Million in Prop. 56 Tobacco Tax Revenues to Boost Medi-Cal Provider Rates

The 2017-18 state budget package resolves a months-long disagreement between the Governor and legislators over how to spend new Prop. 56 tobacco-tax revenues that go to Medi-Cal, which provides health coverage for more than 13 million Californians. Approved by voters last November, Prop. 56 raised the state's excise tax on cigarettes by $2 per pack and triggered an equivalent increase in the state excise tax on other tobacco products. These increases, which took effect on April 1, will generate nearly $1.3 billion in new funding for Medi-Cal in 2017-18, according to state projections.

The Prop. 56 compromise, which is contained in AB 120, includes the following elements:

- **Of the $1.3 billion in Prop. 56 funds that are projected to flow to Medi-Cal in 2017-18, up to $546 million could go to doctors, dentists, and certain other Medi-Cal providers as "supplemental payments."** These payments will be divided among five groups of providers: Up to $325 million for physicians; up to $140 million for dentists; up to $50 million for women's health providers; up to $27 million for providers serving people with developmental disabilities; and up to $4 million for providers caring for people with HIV/AIDS. This use of Prop. 56 funds – which state lawmakers promoted, but the Governor initially resisted – reflects the measure's requirement that the tobacco tax dollars directed to Medi-Cal be used "to increase funding for the existing [program]…by providing improved payments for all healthcare, treatment, and services." According to Prop. 56, these "improved payments" must be allocated based on criteria that include 1) ensuring timely access to care, 2) bolstering the quality of care, and 3) addressing provider shortages in various parts of the state.
- **The state Department of Health Care Services (DHCS) will determine the rules for allocating these supplemental payments.** These rules must be posted on the DHCS website by July 31, 2017. AB 120 does not *require* DHCS to solicit public input in developing these rules. However, it seems likely that the Department will reach out to key stakeholders in order to help ensure that the supplemental payments are structured in a way that will achieve the goals established by Prop. 56.

- **Prop. 56-funded supplemental payments will be disbursed only if:**
  - **California receives "all necessary federal approvals" in order to ensure that federal Medicaid matching funds will be available to the state.** Supplemental payments will be independently allocated by provider type as federal approval is received for that category of providers. At a Senate Budget and Fiscal Review Committee hearing on June 13, Senator Holly Mitchell – the committee chair – indicated that the intent is to provide supplemental payments retroactive to July 1, 2017, even if federal approval were received much later in the fiscal year. If the Trump Administration does *not* approve the state's proposed supplemental payments, then the Prop. 56 revenues that would have funded these payments would have to be used for other purposes in Medi-Cal, although AB 120 does not provide specifics on this point.
  - **The federal government does not cut funding for Medi-Cal.** Supplemental payments will not go into effect (or will be suspended) if federal support for Medi-Cal is reduced below the level projected in the state budget. (The Governor's Department of Finance will make this determination.) While President Trump and Republicans in Congress are attempting to make deep cuts to Medicaid, it's unclear whether any such reductions will be approved and, if they are, how soon they would take effect. If federal Medicaid cuts *do* take effect in the coming fiscal year, then any Prop. 56 revenues that would have funded supplemental payments would have to be used for other purposes in Medi-Cal, although AB 120 does not provide specifics on this point.
- **If California allocates the full $546 million in Prop. 56-funded supplemental payments in 2017-18, the state would receive a projected $613 million in federal Medicaid matching funds.** With these federal funds, a total of up to $1.2 billion in supplemental payments would be available to Medi-Cal providers in 2017-18.
- **The remaining Prop. 56 funds that flow to Medi-Cal will be used to pay for ordinary spending growth in the program.** For example, if the state allocates the full $546 million in supplemental payments in 2017-18, the remaining $711 million in Prop. 56 revenues for that year will go toward routine year-over-year cost increases in Medi-Cal, costs that typically would be paid for with state General Fund dollars. This part of the compromise reflects the Governor's interpretation of Prop. 56 – one that is at odds with how many state lawmakers and Medi-Cal providers interpret the measure.
- **The compromise sets an expectation that the Governor could disburse up to $800 million in Prop. 56 funds as supplemental payments to Medi-Cal providers in 2018-19, which begins on July 1, 2018.** However, the amount of supplemental payments provided in 2018-19 will ultimately be determined based on negotiations between the Governor and legislative leaders as part of the typical state budget deliberations in 2018.

Budget Package Restores Full Dental Services in 2018, Vision Services in 2020, for Adults Enrolled in Medi-Cal

In order to help close a substantial budget gap in 2009, state policymakers eliminated several Medi-Cal benefits for adults that are optional under federal law. (Medi-Cal is California's Medicaid program.) These cuts included optional dental services as well as optometric and optician services. The 2013-14 state budget package restored some optional dental services for adults effective May 1, 2014. These restored services included fluoride treatments, certain crowns, and full dentures, but excluded certain other dental services, such as implants. The 2017-18 budget agreement (Senate Bill 97):

- **Restores, as soon as January 1, 2018, the full array of dental services for adults in Medi-Cal.** This change is estimated to increase General Fund spending by $34.7 million in 2017-18, with estimated full-year costs of $72.9 million beginning in 2018-19. Implementation is contingent on federal approval.
- **Restores, as soon as January 1, 2020, optometric and optician services as a Medi-Cal benefit for adults.** Implementation is contingent on federal approval as well as on funding being provided in the state budget.

Budget Package Shifts In-Home Supportive Services (IHSS) Costs to Counties, but Reduces the Impact

Under the Coordinated Care Initiative (CCI), California integrates health care and other services – including IHSS – for certain seniors and people with disabilities. In January, the Administration indicated that because the CCI is not cost-effective, it will be discontinued in 2017-18, pursuant to current law. Because of how the CCI is structured, one key outcome of discontinuing this initiative is that counties' share of the nonfederal costs for IHSS will go up substantially beginning in July 2017, while the state's share of the costs will drop. (IHSS costs are funded with federal, state, and county dollars.) This past spring, the Administration worked with counties to develop a multifaceted plan to mitigate the impact of this roughly $600 million cost-shift on county budgets. As enacted in SB 90, this plan includes the following elements:

- **Maintains a "maintenance-of-effort" (MOE) structure for sharing nonfederal IHSS costs between the state and counties.** This county MOE structure was implemented in 2012 as part of the CCI. The state General Fund will continue to pay the difference between counties' MOE contribution each year and the total nonfederal share of IHSS costs in each county.

- **Calculates a new MOE base for county IHSS costs in 2017-18 and applies an annual inflation factor to that base beginning in 2018-19.** The MOE base will include the cost of IHSS services along with a limited amount of costs related to IHSS administration. The inflation factor is set at 5 percent for 2018-19 and will rise to 7 percent in 2019-20 and each year thereafter. However, the inflation factor could be lower in any given year depending on the performance of sales and use tax revenues that counties receive as part of their "1991 realignment" funding.
- **Provides counties with General Fund dollars to offset a portion of their increased costs for IHSS.** The state will provide counties with $400 million in 2017-18; $330 million in 2018-19; $200 million in 2019-20; and $150 million in 2020-21 and each year thereafter.
- **Redirects, for five years, certain 1991 realignment "growth" funds in order to offset a portion of counties' increased costs for IHSS.** For the first three years, SB 90 redirects *all* Vehicle License Fee growth funds from various 1991 realignment subaccounts, including one that provides funding for mental health services. In the fourth and fifth years, the amount of redirected revenues would be cut in half.
- **Allows counties to avoid repaying revenues that they received in error due to miscalculations by the state Board of Equalization.** This amount ranges from $100 million to $300 million, according to the California State Association of Counties (CSAC).
- **Allows counties that are "experiencing significant financial hardship" due to higher IHSS costs to seek a low-interest loan from the state.** This loan option would be available through 2019-20. Loans would have to be paid back within three years.

With this mitigation plan in place, counties' additional costs for IHSS are expected to be relatively manageable in 2017-18 and 2018-19. However, CSAC warns that the potential for a 7 percent jump in counties' IHSS contribution in 2019-20 "is problematic…and will lead to growing county general fund impacts." Any remaining county concerns could be addressed relatively soon: SB 90 requires the Governor's Department of Finance – in developing the 2019-20 budget – to meet with CSAC and other organizations to examine various issues related to the 1991 realignment, including IHSS costs.

Budget Package Mitigates Cut to Key CalWORKs Funding Source and Calls for Change in Allocation Methodology

The California Work Opportunity and Responsibility to Kids (CalWORKs) Program provides modest cash assistance for 875,000 low-income children while helping parents overcome barriers to employment and find jobs. Counties receive most of their funding to support CalWORKs activities (including employment services, some child care and case management, and eligibility and other administration services) through the "CalWORKs single allocation," which has historically been budgeted based on projected caseload. Because the CalWORKs caseload is expected to decline next year, the Governor proposed reducing the single allocation by roughly $250 million, about a 13 percent cut relative to the 2016-17 allocation. Counties objected to this cut, citing their limited ability to quickly reduce spending in response to changes in caseload, as well as the need to maintain a baseline level of infrastructure and service capacity in order to be able to respond to future caseload increases. In response to these concerns, the 2017-18 budget agreement reduces the proposed cut to the single allocation with a one-time $108.9 million augmentation, resulting in an overall net reduction to the single allocation of about $140 million compared to the 2016-17 fiscal year. The budget agreement also requires the Administration to work with counties to revise the methodology for developing the single allocation.

The budget agreement does not propose new increases to CalWORKs basic grants or time limits, though this would be necessary to restore cuts made to the program during and after the Great Recession. However, the budget does include some new investments in welfare-to-work services and infrastructure, including financial incentives for participants engaged in education, expansion of substance abuse services to children of CalWORKs participants, and investments in data and evaluation systems.

Budget Agreement Provides Increased Resources to Address Federal Actions on Immigration and Other Issues

A California was home to more than 10.7 million foreign-born residents as of 2015. This includes a significant number of undocumented immigrants and their children, who are often US citizens. Aggressive federal enforcement of immigration laws has been an area of particular tension between the Trump administration and California's state and local governments, and the 2017-18 budget package adopts three new proposals that aim to address this issue. Specifically, the budget agreement:

- **Prohibits local law enforcement agencies from establishing new contracts or expanding existing contracts with federal authorities to provide space to detain noncitizens facing federal immigration charges.** This provision applies to contracts for detaining both noncitizen adults and accompanied or unaccompanied minors.
- **Requires the Attorney General to review conditions and policies in California detention facilities that hold individuals facing federal immigration charges.** The budget provides $1 million to support these activities.
- **Dedicates $45 million General Fund to the Department of Social Services to increase the availability of legal services for people seeking help with naturalization, deportation defense, and securing legal immigration status.** These funds represent an increase over the $30 million for this purpose previously proposed by the Governor.

The enacted budget also maintains the $6.5 million General Fund and 31 positions in the Department of Justice proposed by the Governor for "new legal workload related to various actions taken at the federal level." These funds are intended to address federal actions broadly in the areas of public safety, health care, the environment, consumer affairs, and general constitutional issues, including actions that may affect the California Secure Choice Retirement Savings Program.

Supplemental Payment for State Employee Pensions Included in Budget Package

The budget package includes higher levels of contributions to state-run retirement systems: the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). CalPERS and CalSTRS, like many retirement systems, are not funded at levels that will keep up with future benefits, resulting in the state needing to make annual contributions in order to pay down unfunded liabilities. The state's unfunded liabilities in the two retirement systems have grown recently as a result of lower-than-expected investment returns and changes to the assumptions the systems make about *future* investment returns. Greater unfunded liabilities from lower investment returns, in turn, mean that state General Fund contributions to the two systems must increase.

The enacted budget includes additional General Fund contributions as a result of CalPERS and CalSTRS reducing the "discount rate" from 7.5 percent to 7.0 percent over the next several years. The discount rate is the assumed future rate of return on investments that is used to estimate the level of contributions from the state and employers.

In addition, the budget includes a supplemental payment to CalPERS of $6 billion, using revenues borrowed from the Surplus Money Investment Fund, a state cash-flow and short-term investments account that is used to pool and invest state funds until they are needed. The purpose of this loan is to help offset increases in state contributions in future years – essentially refinancing a liability to CalPERS. The loan will allow the funds to be invested at CalPERS' assumed investment return rate (discount rate) of 7 percent, as opposed to the less than 1 percent currently earned by the funds. The Administration estimates that over two decades this will generate an additional $11 billion (after paying for the costs of the loan), helping to reduce state contributions to CalPERS. The General Fund's share of the repayment of the loan will be covered by funds set aside by Prop. 2 (2014) for repayment of budgetary debt. The rest of the loan repayment will come from a series of state special funds. In other words, the intention is that repaying the loan will not come from money that could otherwise be used to increase spending for other General Fund programs.

Budget Provides More Than $11 Billion for the California Department of Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation (CDCR) operates the state's prison and parole systems. Funding for the CDCR supports the cost of housing men and women in state prisons and other correctional facilities, providing health care and rehabilitation services, and supervising people who have been released back to their communities after completing their prison terms. CDCR's budget also pays for youth correctional operations and services that are provided at the state level.

The 2017-18 budget provides $11.1 billion in General Fund support for CDCR operations. Overall General Fund spending for CDCR, including support for capital outlay, is equal to 8.9 percent of total enacted 2017-18 General Fund expenditures. In a significant change, the CDCR's budget includes – effective July 1, 2017 – $254.4 million that was previously budgeted through the Department of State Hospitals (DSH). These dollars pay for the operation of 1,156 inpatient mental health treatment beds at three state prisons – beds that are part of the broader system of mental health care that is provided to incarcerated adults. Transferring responsibility for these psychiatric services from the DSH to the CDCR is intended to "streamline processes and improve timelines for inmate referrals for psychiatric inpatient treatment," according to the Administration's summary of the budget package.

Budget Package Highlights Anticipated Reduction in Prison Population Due to Prop. 57

Currently, more than 131,100 people are serving sentences at the state level in the custody of the CDCR. Most of these individuals – over 115,100 – are housed in state prisons designed to hold slightly more than 85,000 people. This level of overcrowding is equal to 135.3 percent of the prison system's "design capacity," which is below the prison population cap – 137.5 percent of design capacity – established by a federal court order. In addition, California houses approximately 16,000 individuals in facilities that are not subject to the court-ordered population cap, including fire camps, in-state contract beds, out-of-state prisons, and community-based facilities that provide rehabilitative services.

The total number of people incarcerated by the state has declined by roughly one-quarter since peaking at 173,600 in 2007. This substantial reduction resulted largely from a series of policy changes adopted by state policymakers and the voters in the wake of the 2009 federal court order requiring the state to reduce overcrowding in state prisons.

California voters added a new reform last year by approving Prop. 57, which gives state officials new policy tools to address ongoing overcrowding in state prisons. Prop. 57 requires parole consideration hearings for state prisoners who have been convicted of a nonviolent felony and have completed the full term for their primary offense. The measure also gives the CDCR – which is part of the Governor's administration – broad new authority to award sentencing credits to reduce the amount of time that people spend in prison. Prop. 57 requires the CDCR to adopt regulations implementing both of these provisions. Finally, Prop. 57 requires juvenile court judges to decide whether a youth should be tried in adult court.

Earlier this year, the Administration drafted emergency regulations to implement Prop. 57, which were approved by the Office of Administrative Law in April. Based on these emergency rules (as published):

- The new parole consideration process for nonviolent offenders was scheduled to take effect on July 1, 2017.
- New and enhanced sentencing credits for completion of education and rehabilitation programs are scheduled to be implemented on August 1, 2017. (Enhanced sentencing credits for good conduct took effect on May 1.)

The 2017-18 budget package estimates that in 2017-18, Prop. 57 will reduce the number of inmates by 2,675 *below* the level that was otherwise projected (130,368). This annual drop in the inmate population is projected to grow to about 11,500 in 2020-21. A declining inmate population will allow the CDCR "to remove all inmates from one of two remaining out-of-state facilities in 2017-18, and begin removing inmates from the second facility as early as January 2018," according to the Administration's summary of the budget package. The budget agreement assumes that Prop. 57 will result in net state savings of $38.8 million in 2017-18, rising to about $186 million by 2020-21.

Budget Agreement Reorganizes State Tax Administration and Limits Board of Equalization's Duties

The California Board of Equalization (BOE) currently operates over 30 tax and fee programs and has a quasi-judicial role in ruling on tax appeals. In addition, an elected five-member board governs the BOE, and BOE board members often view themselves in a quasi-legislative role.

There has been longstanding concern regarding the BOE's conflicting roles and responsibilities, and a recent audit by the Department of Finance showed recent misuse of BOE resources, board member interference in routine operations, and an inability to report accurate and reliable information to the Legislature or the Administration.

In response, the 2017-18 budget agreement reorganizes the BOE's roles and responsibilities and in doing so creates two new state entities: the California Department of Tax and Fee Administration (CDTFA) and the Office of Tax Appeals (OTA). Under the reorganization, the BOE will retain the core duties specified in the state Constitution, including equalizing county property tax rates, assessing certain intercounty and business property, assessing taxes on insurers, and assessing and collecting alcohol excise taxes. The CDTFA and the OTA will have responsibility for other BOE operations that are defined by state statute. The CDTFA will have responsibility for administering other BOE tax and fee operations, and the OTA will have responsibility for ruling on tax appeals. The reorganization of state tax administration took effect on July 1, 2017.

Budget Agreement Reflects Recently Approved Transportation Funding Package

California's expansive transportation infrastructure includes 50,000 lane-miles of state and federal highways, 304,000 miles of locally owned roads, Amtrak intercity rail services, and numerous local transit systems, all of which facilitate the movement of people and goods across the state. The state's largest category of deferred maintenance is for its existing transportation facilities.

The final 2017-18 budget includes an agreement with the Legislature on a 10-year, $54 billion transportation funding package. This includes $2.8 billion for 2017-18.

The funding will be split equally between state and local transportation programs over the next 10 years. Major state-level allocations include:

- $15 billion for highway repairs.
- $4 billion in bridge repairs.
- $3 billion to improve trade corridors.
- $2.5 billion to reduce congestion on major commute corridors.

Major local-level allocations include:

- $15 billion for local road repairs.
- $8 billion for public transit and intercity rail.
- $2 billion for local "self-help" communities that are making their own investments in transportation improvements.
- $1 billion for active transportation projects to better link travelers to transit facilities.

The funding package relies on new revenues generated from a series of tax and fee increases:

- $24.4 billion from a 12-cent increase in the base gas excise tax starting on November 1, 2017.
- $10.8 billion from a 20-cent increase in the diesel fuel base excise tax and a 5.75-cent increase in the diesel fuel sales tax starting on November 1, 2017.
- $16.3 billion from a new annual transportation improvement fee that will take effect on January 1, 2018. This fee will range from $25 to $175 per vehicle based on the value of the vehicle. (For instance, a vehicle valued at less than $5,000 would incur a fee of $25, while a vehicle valued at $60,000 or more would incur a $175 fee.)
- $200 million from a new annual fee of $100 on all zero-emission vehicles starting on July 1, 2020.

In addition, the base gas and diesel fuel excise taxes, the new transportation improvement fee, and the new zero emissions vehicle fee will be annually adjusted for inflation starting in 2020-21.

Budget Makes No New Investments in SSI/SSP or Housing, Leaves Cap-and-Trade Allocation Unresolved

The 2017-18 budget agreement includes no new investments in some services and supports that help Californians who have low incomes. In addition, the current budget package leaves unsettled the issue of how to allocate "cap and trade" revenues in 2017-18. Specifically, the budget package:

- **Does not provide a COLA for SSI/SSP grants.** Supplemental Security Income/State Supplementary Payment (SSI/SSP) grants help well over 1 million low-income seniors and people with disabilities to pay for housing, food, and other basic necessities. Grants are funded with both federal (SSI) and state (SSP) dollars. Last year, the state approved a state COLA for the SSP portion of the grant, which took effect in January 2017, but no new state COLA was approved for 2017-18.
- **Does not propose any new funding to address California's affordable housing crisis.** No major new state funds are allocated to support affordable housing in the budget agreement, though multiple proposals to invest in housing are still pending in the Legislature. The budget does include $43.5 million for the Housing and Disability Advocacy Program, which was created as part of the budget package that was signed into law *last year*, but which was never implemented. This program is intended to help people who are homeless or at risk of homelessness and who have a disability to access appropriate benefits. The $43.5 million in funding provided for 2017-18 is carried forward from the 2016-17 budget.

- **Does not resolve the question of allocating cap-and-trade revenues.** California's cap-and-trade program sets a statewide limit on the emission of greenhouse gases (GHGs) and authorizes the Air Resources Board (ARB) to auction off emission allowances, with proceeds invested in activities that seek to reduce GHG emissions. In January, the Governor proposed allocating cap-and-trade funds contingent on the Legislature confirming – with a two-thirds vote in each house – the ARB's authority to administer the cap-and-trade program beyond 2020. This legislative action has not yet occurred, though negotiations on this vote continue.