May Revision 2016-17

Edmund G. Brown Jr. Governor
State of California

Introduction

Since the January Budget, the state's revenues have lagged expectations while the Governor and the Legislature have made major new spending commitments:

- The tax revenue forecast has been reduced by $1.9 billion, reflecting poor April income tax receipts and more sluggish sales tax receipts than expected.
- The passage of the managed care organization financing package solidifies funding for Medi-Cal over the next three years.
- Additional funding was committed to developmental disability services, higher payments to Medi-Cal providers, and the reduction of debt.
- The passage of legislation that made California the first state in the nation to raise the statewide minimum wage to $15 per hour will eventually raise General Fund costs by an estimated $3.4 billion ($39 million in 2016-17).

As the economy has recovered since the Great Recession, the state has made additional dramatic increases in permanent spending obligations, particularly in programs to counteract the effects of poverty. Since 2012, the expansion of health care coverage, the Local Control Funding Formula, and other increases in safety net spending have committed over $19 billion in increased annual General Fund costs ($10.7 billion Proposition 98).

Barring any significant changes, the budget over the next two years is in balance. Proposition 2's required contributions to debt payment and the Rainy Day Fund have been reduced by a combined $1.6 billion since January. These reductions, based on declining revenues and reduced capital gains expectations, keep the budget from being worse off.

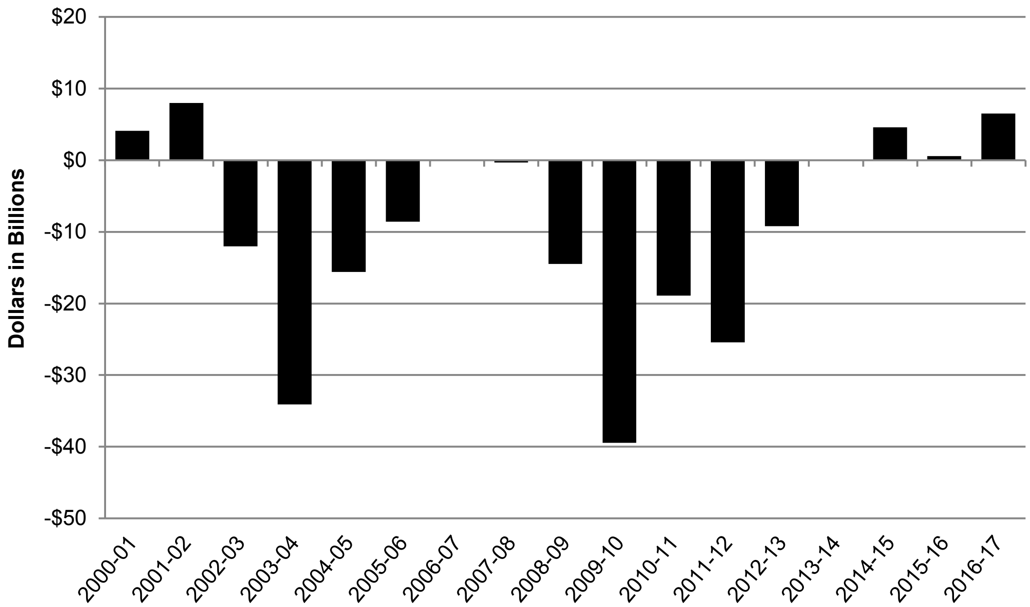
However, in the coming years, the state's commitments will exceed expected revenues. By 2019-20, the annual shortfall between spending and revenues is forecast to be over $4 billion. This shortfall does not take into account the likelihood of an economic slowdown or recession. The emerging shortfall is in large part—but not entirely—due to the expiration of the temporary taxes imposed under Proposition 30. This November, the state's voters will be given the choice whether to extend the Proposition 30 income tax rates for another 12 years. Even if the voters pass this extension of taxes, the longer-term budget outlook would be barely balanced. The cost of any additional new programs or obligations beyond the May Revision would need to be paid for through cuts in other programs or further tax increases beyond the Proposition 30 rates. If instead the voters do not pass the extension of taxes, the state will need to cut spending. Until the voters decide this important question, <u>no significant new ongoing spending commitments should be made</u>. The May Revision reflects this principle.

By the time the Budget is enacted in June, the economy will have finished its seventh year of expansion, two years longer than the average recovery. The next recession is getting closer—even if we cannot tell exactly when it will hit. The outcome of the vote on the extension of Proposition 30 taxes will not change the need to plan for a recession. If the taxes are extended, the state will still need a sizable Rainy Day Fund given the volatility of the income taxes on the state's wealthiest residents. Without a tax extension, the state will have less ongoing tax revenues to support its current fixed commitments, meaning that a strong Rainy Day Fund is even more important to protect against devastating cuts.

Maintaining Fiscal Balance Is an Ongoing Challenge

The fiscal stability from a balanced budget and a recovering state economy has been a welcome reprieve from the prior decade's budget deficits. Yet maintaining a balanced budget for the long term will be an ongoing challenge—requiring restraint and prudence. As shown in Figure INT-01, since 2000, the state's short periods of balanced budgets

Figure INT-01
Balanced Budgets Have Been Quickly Followed by Huge Deficits[1]



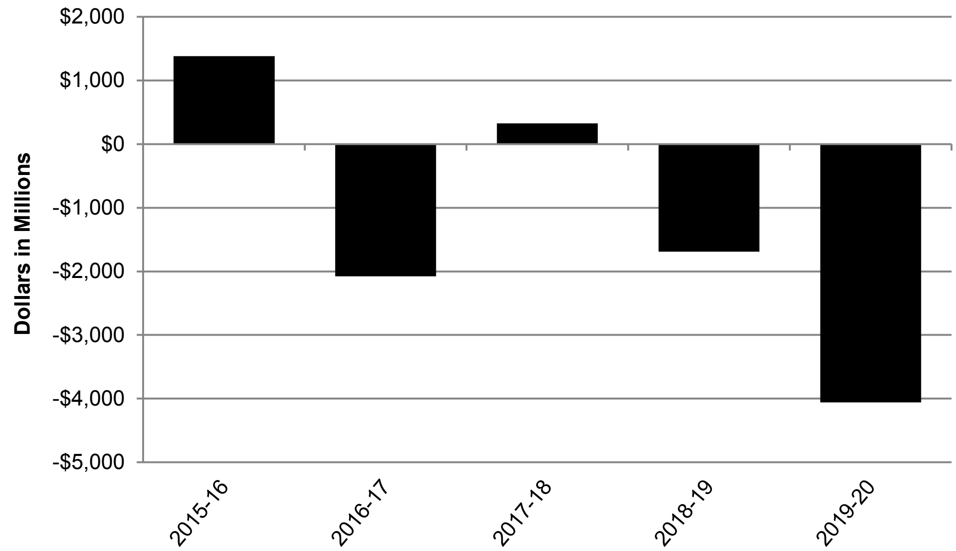
[1] Budget shortfalls or surplus, measured by the annual Governor's Budget.

have been followed by massive budget shortfalls. In fact, the sum of all the deficits during this period is seven times greater than the sum of all the surpluses.

With California's complicated budget, there will continue to be year-to-year fluctuations, risks and cost pressures, including from the federal government and ballot initiatives. Since January alone, forecasted revenues have dropped by nearly $2 billion and the federal government has issued managed care regulations that will likely drive up state Medi-Cal costs by hundreds of millions of dollars annually.

The current fiscal year is the last one with the full revenues of Proposition 30. Given that the state has added considerable ongoing commitments since its passage, the budget is currently projected to return to deficit spending when Proposition 30 revenues expire. As shown in Figure INT-02, without corrective action, the state will spend nearly $1.7 billion more than it receives in 2018-19 and $4 billion more than it receives in 2019-20 — the first year when no Proposition 30 revenues will be collected. If the voters choose to extend the taxes at the November election, the state's books will again come into balance but only by a few hundred million dollars each year.

Figure INT-02
Deficit Spending on the Horizon



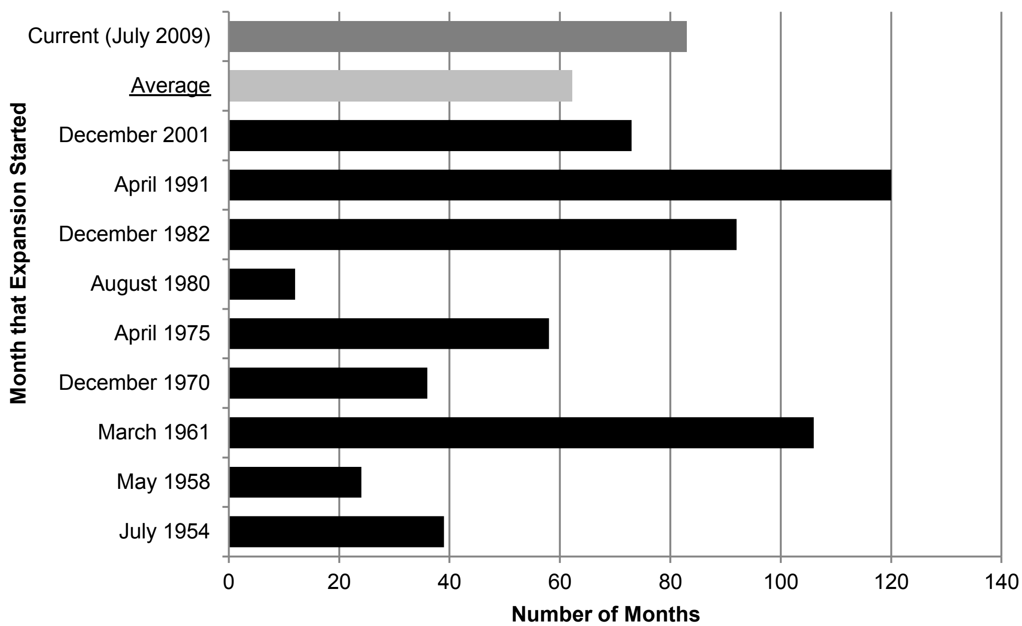
Planning for the Next Recession

The passage of Proposition 2 in 2014 gives the state an opportunity to mitigate the boom-and-bust cycle of the past two decades. Recent budget shortfalls have been driven by making ongoing commitments based upon temporary spikes in revenues primarily from capital gains. Under Proposition 2, these spikes in capital gains will instead be used to save money for the next recession and to pay down the state's debts and liabilities. Proposition 2 establishes a constitutional goal of having 10 percent of tax revenues in the Rainy Day Fund.

The budget assumes the continued expansion of the economy. There are few signs of immediate contraction at this point. Yet, economic expansions do not last forever. In the post-war period, the average expansion has been about five years. As shown in Figure INT-03, the current expansion has already exceeded the average by two years.

Prior to the start of the last two recessions (which began in 2001 and 2007), the state significantly increased its spending, had structurally imbalanced budgets, and had minimal reserves. As a result of paying off many of its budgetary debts and setting aside funds in the Rainy Day Fund, there is no doubt that California is better prepared for a

Figure INT-03
Current Recovery Already Two Years Longer Than Average



recession than it was for these last two. But that is hardly the standard to which the state should aspire.

Another recession is inevitable and the state must plan for it. To that end, in January, the Department of Finance modeled a recession of average magnitude to occur in 2017-18. Under this forecast, revenues from the state's "big three" taxes—the personal income, sales, and corporation taxes—dropped a total of $55 billion from the start of the recession through 2019-20.

In April, Moody's Investors Service released a report that assessed California's preparedness for the next recession compared to other larger states. Among 20 states, California was 19th in its preparedness, ahead of only Illinois. The state's key areas of vulnerability were:

- Revenue Volatility—California's heavy dependence on a progressive income tax makes it highly susceptible to stock market and other economic fluctuations. Proposition 30's higher income tax rates have temporarily made the state's taxes even more volatile. The top 1 percent of Californians account for 48 percent of the state's income taxes, which in turn accounts for two-thirds of General Fund taxes.

- Size of Reserves—Proposition 2 has improved the state's ability to save. But even accounting for the Governor's proposed $2 billion supplemental deposit, the state's Rainy Day Fund would only reach 54 percent of its constitutional target this year.
- Revenue and Spending Flexibility—The state Constitution, combined with the extensive entitlements for poverty-focused programs, restricts the state's ability to react to worsening economic conditions as quickly as other states.
- Fixed Costs—Infrastructure debt and retirement obligations lock in more than 10 percent of General Fund spending, which can only be changed over many years. The state has issued tens of billions of dollars in infrastructure bonds in the past decade. In addition, as shown in Figure INT-04, the state has $232 billion in long-term costs, debts, and liabilities. The vast majority of these liabilities—$228 billion—are related to retirement costs of state and University of California employees.

Figure INT-04

Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2

(Dollars in Millions)

	Outstanding Amount at Start of 2016-17	Proposed Use of 2016-17 Pay Down at Governor's Budget	Changes from Governor's Budget	Proposed Use of 2016-17 Pay Down at May Revision
Budgetary Borrowing				
Loans from Special Funds	$1,819	$955	-$263	$692
Underfunding of Proposition 98—Settle-Up	1,232	257	-39	218
Repayment of pre-Proposition 42 Transportation Loans	879	173	0	173
State Retirement Liabilities				
State Retiree Health	74,103	0	38	38
State Employee Pensions	49,592	0	0	0
Teacher Pensions [1]	72,626	0	0	0
Judges' Pensions	3,279	0	0	0
Deferred payments to CalPERS	570	0	0	0
University of California Retirement Liabilities				
University of California Employee Pensions	10,786	171	0	171
University of California Retiree Health	17,270	0	0	0
Total	**$232,156**	**$1,556**	**-$264**	**$1,292**

[1] The state portion of the unfunded liability for teacher pensions is $13.939 billion.

In recent years, the state has sought to enhance its future budget flexibility such as with the recently enacted minimum wage increase, which allows the Governor to pause future increases when faced with budget deficits or recessions. The state has also made great strides to reduce its fixed costs by avoiding excessive bond debt, implementing pension reform in 2012, and beginning to prefund retiree health benefits. Proposition 2 provides a dedicated funding source to help address retirement liabilities for 15 years, but that funding alone will not eliminate the liabilities.

In the short term, fully filling the Rainy Day Fund by the time the next recession begins should be the primary fiscal goal of the state. It is the only preparedness factor that can be improved quickly.

Counteracting the Effects of Poverty

For the last several years, the Census Bureau has reported that about 16 percent of California residents are living in poverty—slightly above the national average of 14.8 percent. The Census Bureau's supplemental measure of poverty, which considers broader measures of income and the cost of living, reflects an even higher poverty rate. While the state's economic condition has improved since the Great Recession, much of the gains are being made by the state's wealthiest residents.

California has an extensive safety net for the state's neediest residents who live in poverty, and the state maintained these core benefits despite the recession. Compared to other states, California provides broader health care coverage to a greater percentage of the population, including in-home care. California makes available higher cash assistance to families, continues that assistance to children after their parents lose eligibility, and provides extensive child care to working families with children up to age 13. Finally, the state provides generous financial aid to those seeking higher education.

In the past three years, the state has taken even greater steps to assist the state's neediest residents. The implementation of health care reform has increased coverage under Medi-Cal to an additional 6 million Californians in just four years. The Local Control Funding Formula is concentrating the greatest school funding to those students with the greatest needs. The state guaranteed that 6.5 million workers are eligible for sick leave. The 2015 Budget Act created California's first-ever earned income tax credit to help the poorest working families in California and encourage more families to claim the existing federal credit.

The January Budget proposed the first state cost-of-living increase for Supplemental Security Income/State Supplementary Payment (SSI/SSP) recipients since 2005. In April, the Governor signed legislation that will raise the minimum wage for all workers to $15 per hour as soon as 2023.

The full costs of many of these increases have already been built into the Budget. In the case of the Medi-Cal expansion and the minimum wage increases, however, the General Fund has only begun to pay the cost. The federal government will begin reducing its share of the Medi-Cal expansion costs beginning in 2017, and the costs of the minimum wage will hit the budget each year for higher in-home care and developmental disability costs as additional wage hikes occur. Accounting for the full implementation costs, the General Fund has incurred new obligations in the effort to counteract the effects of poverty totaling more than $19 billion (about $10.7 billion of which will be paid for through Proposition 98 funds). These costs are summarized in Figure INT-05.

Reducing the Cost of Housing

California's housing costs are extremely high. Approximately 1.5 million low-income California households pay more than half their income in rent, straining their ability to pay for other household expenses. In addition, the state has a disproportionately high share of the nation's homeless and chronically homeless.

The May Revision reflects $3.2 billion in state and federal funding and award authority for various affordable housing and homelessness programs. This amount includes recently created programs that pay for affordable housing in sustainable communities and housing for veterans. There is increasing evidence that demonstrates the effectiveness of interventions such as rapid rehousing and permanent supportive housing in addressing chronic homelessness. The creation of a $35 million housing program within CalWORKs over the last two years, California Housing Finance Agency's Special Needs Housing Program established this year, and the new Emergency Solutions Grant regulations recently promulgated by Department of Housing and Community Development (HCD) are using this approach.

Building upon these current efforts, the May Revision endorses the Senate's concept of a $2 billion bond from a portion of future Proposition 63 mental health revenues. This funding would enable HCD to develop and administer homelessness and affordable housing programs through a Mental Health Services Act-Supportive Housing Program and Tenant-Based Rental Assistance Program, with a particular focus on

Figure INT-05

Major Poverty-Focused Budget Actions Since 2012

Minimum Wage	
• Increase from $8/hour to $10/hour	$208 million
• Increase from $10/hour to $15/hour and extend paid sick leave	$3.4 billion
Medi-Cal	
• Optional expansion under Affordable Care Act	$2.1 billion
• Exemptions from provider cuts	$387 million
• Adult Dental restoration	$170 million
• Full Scope Services for Undocumented Children	$229 million
CalWORKs	
• 11.4 percent in cost-of-living increases[1]	$362 million
• Enhanced employment and early engagement services	$288 million
• Creation of designated housing assistance	$35 million
CalFresh	
• Work Incentive Nutritional Supplement	$33 million
• State Utility Assistance Subsidy	$15 million
In-Home Supportive Services	
• Overtime	$468 million
• Restoration of 7 percent of hours	$266 million
Earned Income Tax Credit	
• Creation of California credit	$295 million
Child Care	
• Various increases to rates and slots	$289 million
Cal Grants	
• Various augmentations and restorations	$176 million
SSI/SSP	
• 2.76 percent cost-of-living increase	$74 million
Proposition 98	
• Local Control Funding Formula—Supplemental and concentration grants for low-income and English Learner students	$10.2 billion
• State Preschool—various increases to rates and slots	$307 million
• Community Colleges Student Equity funding increases	$155 million
• Community College Full-Time Student Success Grants	$41 million
Total:	**$19.5 billion ($10.7 billion Prop 98, $8.4 billion General Fund, $0.4 billion Local Realignment Fund)**

Note: Fiscal estimates reflect fully implemented costs.
[1] Funded by 1991-92 State-Local Realignment Revenues.

chronic homelessness. The May Revision proposes first-year funding of $267 million from the bond proceeds.

Local land use decisions surrounding housing production have contributed to low inventories — even though demand has steadily increased. Local land use permitting and review processes have lengthened the approval process and increased production costs. Ultimately, the state's housing affordability will improve only with new approaches that increase the housing supply and reduce its cost. The Legislature is currently considering a number of these approaches. The May Revision proposes additional legislation requiring ministerial "by right" land use entitlements for multifamily infill housing developments that include affordable housing. This would help constrain development costs, improve the pace of housing production, and encourage an increase in housing supply. It is counterproductive to continue providing funding for affordable housing under a system that slows down approvals in areas already vetted and zoned for housing.

Continuing to Invest in Education, Infrastructure, and Sustainability

The May Revision continues to prioritize funding for education, infrastructure, and sustainability.

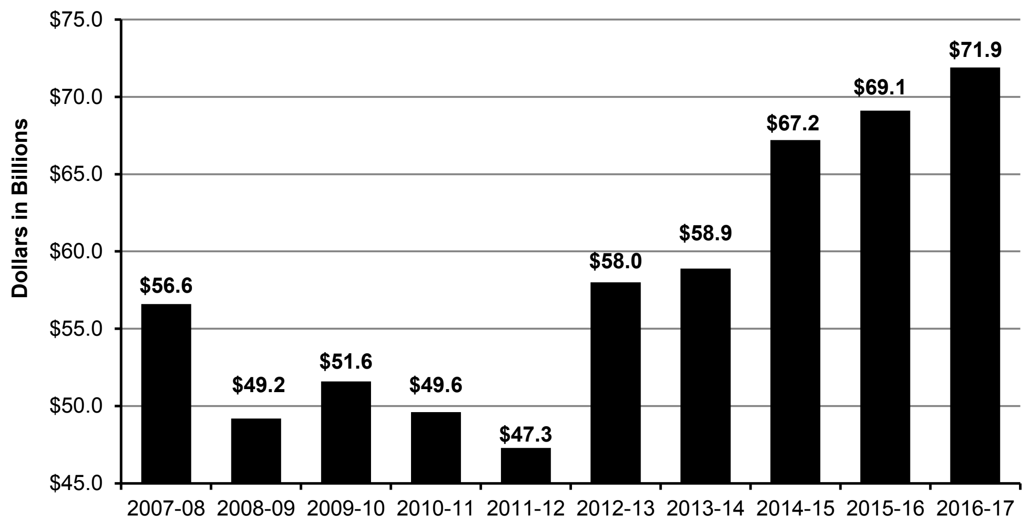
Investing in Education

The Proposition 30 temporary taxes were premised on the need to increase funding for education. As shown in Figure INT-06, the minimum guarantee of funding for K-14 schools was $56.6 billion in 2007-08 and sank to $47.3 billion in 2011-12. From this recent low, funding has been at all-time highs since 2012-13 and is expected to grow to $71.9 billion in 2016-17, an increase of $24.6 billion in five years (52 percent).

For K-12 schools, funding levels will increase by over $3,600 per student in 2016-17 over 2011-12 levels. This reinvestment provides the opportunity to correct historical inequities in school district funding with continued implementation of the Local Control Funding Formula. The May Revision provides $2.9 billion in new funding, bringing the formula's implementation to 96 percent complete.

The Budget also invests in the state's higher education system to maintain the quality and affordability of one of California's greatest strengths. The Budget keeps tuition at

Figure INT-06
Proposition 98 Funding
2007-08 to 2016-17



2011-12 levels. The May Revision commits $25 million in new funding for the California State University to reduce the time it takes a student to successfully complete a degree.

Strengthening Infrastructure

The construction and maintenance of key physical infrastructure is one of the core functions of state government. Infrastructure and capital assets allow for the delivery of public services and the movement of goods across the state—both essential components in fostering the state's long-term economic growth.

The May Revision continues to reflect the Governor's transportation package that would provide $36 billion over the next decade to improve the maintenance of highways and roads, expand public transit, and improve critical trade routes. The increased funding would be coupled with Caltrans efficiencies, streamlined project delivery, and accountability measures. The budget also includes $737 million ($500 million General Fund) for critical deferred maintenance at levees, state parks, universities, community colleges, prisons, state hospitals, and other state facilities, as well as a $1.5 billion General Fund down payment in improving Sacramento office buildings including the State Capitol Annex.

Addressing Climate Change

The California Global Warming Solutions Act of 2006 (AB 32) set California's initial greenhouse gas emission reduction goals, and directed the state to maintain and continue reductions beyond 2020. Last year, California adopted several ambitious policies that will further advance clean energy and significantly reduce greenhouse gas emissions. The Budget supports these efforts with a $3.1 billion Cap and Trade expenditure plan that will reduce greenhouse gas emissions through programs that support clean transportation, promote transformational sustainable communities, reduce short-lived climate pollutants, and protect natural ecosystems. Over multiple years, the Cap and Trade program gives the state the chance to transform its communities—particularly those disadvantaged ones—into innovative, sustainable economic centers.

Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2016-17 May Revision

General Fund Budget Summary

(Dollars in Millions)

	2015-16	2016-17
Prior Year Balance	$3,444	$4,829
Revenues and Transfers	$117,000	$120,080
Total Resources Available	**$120,444**	**$124,909**
Non-Proposition 98 Expenditures	$65,842	$71,050
Proposition 98 Expenditures	$49,773	$51,105
Total Expenditures	**$115,615**	**$122,155**
Fund Balance	**$4,829**	**$2,754**
Reserve for Liquidation of Encumbrances	$966	$966
Special Fund for Economic Uncertainties	$3,863	$1,788
Budget Stabilization Account/Rainy Day Fund	**$3,421**	**$6,713**

Figure SUM-02

General Fund Expenditures by Agency

(Dollars in Millions)

	2015-16	2016-17	Change from 2015-16 Dollar Change	Change from 2015-16 Percent Change
Legislative, Judicial, Executive	$3,245	$3,404	$159	4.9%
Business, Consumer Services & Housing	637	432	-205	-32.2%
Transportation	258	237	-21	-8.1%
Natural Resources	2,714	2,801	87	3.2%
Environmental Protection	223	86	-137	-61.4%
Health and Human Services	31,514	32,995	1,481	4.7%
Corrections and Rehabilitation	10,182	10,775	593	5.8%
K-12 Education	49,566	51,200	1,634	3.3%
Higher Education	14,275	14,300	25	0.2%
Labor and Workforce Development	212	173	-39	-18.4%
Government Operations	761	2,256	1,495	196.5%
General Government:				
Non-Agency Departments	708	736	28	4.0%
Tax Relief/Local Government	445	485	40	9.0%
Statewide Expenditures	875	2,275	1,400	160.0%
Total	**$115,615**	**$122,155**	**$6,540**	**5.7%**

Note: Numbers may not add due to rounding.

Figure SUM-03

2016-17 Total State Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$3,404	$4,042	$594	$8,040
Business, Consumer Services & Housing	432	853	405	1,690
Transportation	237	9,892	1,441	11,570
Natural Resources	2,801	1,656	595	5,052
Environmental Protection	86	3,407	340	3,833
Health and Human Services	32,995	20,674	-	53,669
Corrections and Rehabilitation	10,775	2,700	-	13,475
K-12 Education	51,200	96	122	51,418
Higher Education	14,300	106	283	14,689
Labor and Workforce Development	173	711	-	884
Government Operations	2,256	-1,232	6	1,030
General Government				
Non-Agency Departments	736	1,917	1	2,654
Tax Relief/Local Government	485	1,706	-	2,191
Statewide Expenditures	2,275	595	-	2,870
Total	**$122,155**	**$47,123**	**$3,787**	**$173,065**

Note: Numbers may not add due to rounding.

Figure SUM-04
General Fund Revenue Sources
(Dollars in Millions)

	2015-16	2016-17	Change from 2015-16 Dollar Change	Percent Change
Personal Income Tax	$79,962	$83,393	$3,431	4.3%
Sales and Use Tax	25,028	25,727	699	2.8%
Corporation Tax	10,309	10,993	684	6.6%
Insurance Tax	2,486	2,345	-141	-5.7%
Alcoholic Beverage Taxes and Fees	370	376	6	1.6%
Cigarette Tax	87	85	-2	-2.3%
Motor Vehicle Fees	22	22	0	0.0%
Other	551	431	-120	-21.8%
Subtotal	**$118,815**	**$123,372**	**$4,557**	**3.8%**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-1,815	-3,292	-1,477	81.4%
Total	**$117,000**	**$120,080**	**$3,080**	**2.6%**

Note: Numbers may not add due to rounding.

Figure SUM-05
2016-17 Revenue Sources
(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2015-16
Personal Income Tax	$83,393	$1,858	$85,251	$3,472
Sales and Use Tax	25,727	13,166	38,893	1,005
Corporation Tax	10,993	-	10,993	684
Highway Users Taxes	-	4,780	4,780	-221
Insurance Tax	2,345	-	2,345	-141
Alcoholic Beverage Taxes and Fees	376	-	376	6
Cigarette Tax	85	718	803	-22
Motor Vehicle Fees	22	7,917	7,939	1,202
Other	431	18,026	18,457	-1,806
Subtotal	**$123,372**	**$46,465**	**$169,837**	**$4,179**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-3,292	3,292	0	0
Total	**$120,080**	**$49,757**	**$169,837**	**$4,179**

Note: Numbers may not add due to rounding.

K thru 12 Education

California provides instruction and support services to roughly six million students in grades kindergarten through twelve in more than 10,000 schools throughout the state. A system of 58 county offices of education, more than 1,000 local school districts, and more than 1,000 charter schools provide students with instruction in English, mathematics, history, science, and other core competencies to provide them with the skills they will need upon graduation for either entry into the workforce or higher education.

The May Revision includes total funding of $87.6 billion ($51.5 billion General Fund and $36.1 billion other funds) for all K-12 education programs.

Proposition 98

Proposition 98 is a voter-approved constitutional amendment that guarantees minimum funding levels for K-12 schools and community colleges. The guarantee, which went into effect in the 1988-89 fiscal year, determines funding levels according to multiple factors including the level of funding in 1986-87, General Fund revenues, per capita personal income, and school attendance growth or decline. The Local Control Funding Formula is the primary mechanism for distributing funding to support all students attending K-12 public schools in California.

As a result of revised revenue estimates that indicate higher prior-year revenues, lower anticipated growth in 2015-16, and modest projected growth in 2016-17, Proposition 98 funding obligations increase by a total of $626 million over the three-year period of 2014-15 to 2016-17 relative to the Governor's Budget. Specifically, Proposition 98 guarantee funding increases by $463 million in 2014-15, decreases by $125 million in 2015-16 and increases by $288 million in 2016-17. As a result of these changes, the revised Proposition 98 guarantee levels at the May Revision for the 2014-15 through 2016-17 fiscal years are $67.2 billion, $69.1 billion, and $71.9 billion, respectively.

The Proposition 98 maintenance factor—an indicator of past reductions made to schools and community colleges—totaled nearly $11 billion as recently as 2011-12. At Governor's Budget, it was anticipated that the maintenance factor would be repaid in full by the end of the 2015-16 fiscal year, prior to the creation of additional projected maintenance factor at the end of the 2016-17 fiscal year. As a result of reduced revenue estimates for 2015-16 and increased growth in per capita personal income for 2016-17, year-end maintenance factor balances of $155 million and $908 million are now projected for 2015-16 and 2016-17 respectively.

K-12 Funding Priorities

The May Revision proposes to utilize the combination of increased one-time and ongoing resources to further advance the core priorities of the Administration—paying down debts owed to schools and investing significantly in the Local Control Funding Formula. The formula provides significantly increased local flexibility on spending decisions and additional funding for students most in need of these resources in an effort to narrow the achievement gap and elevate low-achieving students. The May Revision increases funding for the formula by providing an additional $154 million—building upon the more than $2.8 billion provided in the Governor's Budget. In total, the more than $2.9 billion investment will bring the formula to 95.7 percent of full implementation. Added investments in the formula for 2016-17 will continue to reverse the inequities that characterized the prior school finance system, and allow schools to expand programs and services and support other key local investments and priorities. Funding is also provided for various workload adjustments under the new formula, as detailed in the K-12 Budget Adjustments section.

The Governor's Budget proposed almost $1.3 billion in discretionary one-time Proposition 98 funding for school districts, charter schools, and county offices of education. The May Revision proposes an additional $134.8 million, providing a total of more than $1.4 billion in discretionary funding to schools in 2016-17 to further the implementation of the state-adopted academic standards, make necessary investments in professional development, provide teacher induction to beginning teachers, address infrastructure and deferred maintenance needs, and purchase instructional materials and technology to prepare both students and teachers for success. All of the funds provided will offset any applicable mandate reimbursement claims for these entities. These resources, coupled with more than $3.6 billion in one-time Proposition 98 funding provided to schools in the 2015-16 Budget for the same purposes, will substantially reduce the outstanding mandate debt owed to local educational agencies, consistent with the Administration's goal to pay down debt.

Early Education

The Governor's Budget proposed to consolidate state-subsidized early learning programs into a $1.6 billion Early Education Block Grant, which would target children most in need of services, address inequity in the distribution of state funding, and align pre-kindergarten programs with local school district priorities. Through the spring, the Administration engaged in four public comment sessions on the Governor's Budget proposal, and received more than 200 responses on the proposal. Drawing in part on that feedback, the May Revision proposes a detailed implementation plan with the following components:

- A governance structure that includes school districts administering early education programs and county offices of education providing technical support and, where necessary, assisting school districts that lack the infrastructure to operate early education programs.
- A transition year for county offices of education to begin working with school districts and other providers in the region to prepare for program implementation in 2017-18.
- Enhanced alignment of pre-kindergarten and K-12 programs through the development of a regional early learning plan that considers input from school districts, county offices of education, families, teachers, and other community stakeholders.
- The use of an existing locally based quality rating system to define the minimum standards for pre-kindergarten program quality.

- A funding model that maintains current levels of funding for school districts and regions for a period of time as the transition to the new Block Grant model occurs. Future state spending investments will be targeted to those areas of the state that have traditionally lacked an equitable share of total funding.

The May Revision includes $20 million Proposition 98 General Fund ($10 million ongoing and $10 million one-time) for county offices of education to begin work in the budget year to ensure a successful transition to the new early education program.

Significant Adjustment:

- State Preschool — A net decrease of $4.3 million Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 0.47 percent at the Governor's Budget to 0.00 percent at the May Revision.

Teacher Workforce

The traditional pathway to a California teaching credential requires a new teacher to earn a baccalaureate degree and then complete a graduate-level teacher preparation program. This pathway to a preliminary teaching credential takes at least five years — and very often six or seven years — to complete the required coursework and student teaching. As an alternative, some of California's private and public postsecondary institutions offer integrated teacher credential programs, where students have the option of earning a degree and a teaching credential in four years. By enrolling in these programs, students can avoid a year or more of college costs while beginning their teaching careers a year or two earlier. However, currently only a handful of universities and colleges offer such credentialing programs.

The May Revision proposes a $10 million General Fund one-time investment for grants to California postsecondary institutions to improve upon or develop four-year integrated teacher credential programs. Grants of up to $250,000 would provide postsecondary institutions with funding to improve existing or create new integrated programs. Preference would be given to proposals that include partnerships with local community colleges and K-12 local educational agencies. The competitive grant program would be administered by the Commission on Teacher Credentialing, with the funds primarily provided for release time for faculty, creation of courses, summer scholarships for students, and program coordinators. Both public and private universities would be eligible to compete for the grants.

In addition to streamlining the teacher pipeline, the May Revision proposes one-time $2.5 million Proposition 98 General Fund for the California Center on Teaching Careers, a program designed to strengthen statewide recruitment of qualified and capable individuals into the teaching profession. Funds would be used for a competitive multi-year grant to be administered by the Commission on Teacher Credentialing and awarded to a local educational agency to administer the center. The center would support public service announcements, employment referrals, the distribution of recruitment publications and information on financial aid and the availability of teacher preparation programs for prospective teachers, and outreach to high school students, college students, out-of-state teachers, and current credential holders.

Emergency Repair Revolving Loan Program

The current School Facilities Aid Program provides grants to local educational agencies through voter-approved general obligation bond funds to build and modernize school facilities. In the event there is a need to replace or repair facilities due to an imminent health and safety concern, facility hardship grant assistance may be available to local educational agencies. However, the process to request and receive this funding can take several months. During this time period, a school may need to close, thereby displacing its students until the school district is able to address the underlying health and safety issues.

To assist school districts in remediating imminent and critical health and safety facility issues that would cause students to be displaced from an educational setting, the May Revision proposes $100 million in one-time Proposition 98 General Fund to establish a bridge loan program to provide temporary funding to schools with insufficient resources to expeditiously address these imminent health and safety issues. Specifically, these funds are proposed to address "emergency facilities needs"—structures or systems that are in a condition that poses a threat to the health and safety of pupils and staff while at school. As a condition of participation, 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 to educate the displaced students. Subject to an expedited review and approval process by the Department of Education, loan funds could be released in a matter of days to address the necessary repairs and ensure students can quickly return to the classroom. After funds are released, schools would have the option of repaying the loans in full within one year of disbursement without interest, or by structuring a long-term low-interest repayment plan not to exceed 20 years.

K-12 Budget Adjustments

Significant Adjustments:

- Local Property Tax Adjustments—A decrease of $196.5 million Proposition 98 General Fund in 2015-16 and $211.3 million in 2016-17 for school districts, special education local plan areas, and county offices of education as a result of higher offsetting property tax revenues.
- Special Education Property Tax Adjustment—An increase of up to $28.5 million Proposition 98 General Fund in 2015-16, provided on a contingency basis, for an anticipated shortfall in redevelopment agency property taxes for special education local plan areas. Related language provides a mechanism to distribute up to $28.5 million based on a determination of property taxes reported for special education local plan areas as of the second principal apportionment certification in early June.
- Average Daily Attendance (ADA)—An increase of $11.2 million in 2015-16 and a decrease of $2 million in 2016-17 for school districts, charter schools, and county offices of education under the Local Control Funding Formula as a result of an increase in ADA in 2014-15 which drives projections for 2015-16, and a decrease in ADA for 2016-17.
- Proposition 39—The California Clean Energy Jobs Act was approved by voters in 2012, and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision increases the amount of energy efficiency funds available to K-12 schools in 2016-17 by $33.3 million to $398.8 million to reflect increased revenue estimates.
- Categorical Program Growth—A decrease of $5.7 million Proposition 98 General Fund for selected categorical programs, based on updated estimates of projected ADA growth.
- Cost-of-Living Adjustments—A decrease of $18.6 million Proposition 98 General Fund to selected categorical programs for 2016-17 to reflect a change in the cost-of-living factor from 0.47 percent at the Governor's Budget to 0.00 percent at the May Revision.
- K-12 Mandated Programs Block Grant—An increase of $131,000 Proposition 98 General Fund to maintain statutory block grant funding rates, assuming 100-percent program participation.

Child Care

Subsidized child care supports the gainful employment of working families. The state provides subsidized child care through a variety of programs, administered largely by the California Department of Education. Families can access care either through a collection of providers who contract directly with the state, or through a voucher they give to a provider who best meets their needs for care. These programs vary in minimum program requirements, in the method of provider reimbursement, and in the flexibility offered for parents who work non-traditional hours.

The Governor's Budget proposed requiring the Department of Education to develop a plan for subsidized child care that transitions away from the use of contracts toward a voucher system over the next five years. The May Revision clarifies that the plan should be a streamlined child care system that consolidates the number of child care programs, provides a single reimbursement rate structure (rather than the flat rate and market rate models the state currently uses) that improves provider payment processes, creates one statewide set of minimum program quality standards, is more efficient for families to access, and can be implemented within existing resources.

The 2015 Budget directed the Department of Education to convene two stakeholder workgroups to recommend actions the state may take to increase the administrative efficiency of state-subsidized child care contracts. The workgroups released their recommendations in April of this year. In response, the Administration proposes statutory language in the May Revision that streamlines the processes for single-parent verification and notices to families regarding changes in care. Further, the Administration anticipates that the Department of Education will make regulatory changes aligned with the workgroup recommendations.

Significant Adjustments:

- Stage 2—A decrease of $884,000 non-Proposition 98 General Fund in 2016-17 to reflect a lower estimated increase in the cost per case. Total Stage 2 costs are $421.4 million.
- Stage 3—A decrease of $42.3 million non-Proposition 98 General Fund in 2016-17 to reflect a lower estimated increase in the cost per case and reduced caseload. Total Stage 3 costs are $273.6 million.

- Child Care and Development Funds—A net increase of $55.6 million federal funds in 2016-17 to reflect an increase to the base grant amount and an increase in one-time funds carried over from prior years. Of this increase, $9.2 million is allocated for child care quality activities in accordance with the requirements of the federal Child Care and Development Block Grant Act of 2014. Total ongoing and one-time federal funding is $648.9 million.

- Capped Non-CalWORKs Programs—A net decrease of $3.5 million non-Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 0.47 percent at the Governor's Budget to 0.00 percent at the May Revision.

- Child Care Quality Activities—Provisional language in the May Revision directs the Department of Education to update its Child Care and Development Block Grant State Plan for quality expenditures to prioritize Quality Rating and Improvement System activities.

Higher Education

To provide for students' timely and successful completion of a degree or certificate and to meet the needs of increasingly diverse students, recent budgets have invested in the public higher education segments—the California Community Colleges (CCC), the California State University (CSU), and the University of California (UC). The state has also provided financial aid to students to defray the costs of attending college. The Administration has challenged leaders across the segments to bridge the transition between K-12 and higher education to move more students into college-level courses faster, integrate technology in new ways to improve learning, and expand the availability of online courses to create new pathways to degrees. Continued focus on these initiatives will help maintain affordability and help students earn degrees and credentials in a timely way—allowing them to enter the workforce with the skills they need to be successful.

Investments in Student Success

The May Revision continues the Administration's investment in student success, including total funding of $30 billion ($17 billion General Fund and local property tax and $13 billion other funds) for all higher education entities.

A steady growth in discretionary funding and targeted state initiatives have allowed each segment to focus on improving student outcomes. For example, a focus on more effective basic skills programs will better prepare students for college-level courses, improving the likelihood of timely completion. Notably, the state invested $60 million in one-time Proposition 98 General Fund for the CCC to enhance basic skills programs in last year's budget and the Governor's Budget continues this targeted investment, proposing another $30 million in ongoing funds. Completion at the universities—especially for low-income and underrepresented students—has also been an important focus. The CSU has made efforts to improve graduation rates and the May Revision calls on the University to chart a more ambitious path forward.

California Community Colleges

The Governor's Budget reaffirmed the expectation that segments could do more to broaden access to, and reduce the costs of, high-quality higher education by better integrating technology into instruction. To this end, the Governor's Budget proposed $5 million Proposition 98 General Fund to support the creation of zero-textbook-cost degrees, certificates, and credentials and articulated the expectation that community college districts make these degrees available through an online clearinghouse of effective practices to encourage their adoption across all community college campuses.

The May Revision continues investments in technology within the CCC. Over the past several years, the CCC has worked to expand student access to more online courses. Currently, there are over 11,000 online courses that have been developed and are available throughout California. However, in 2016-17 fewer than 100 of these will be available through the Community College online course exchange, which allows students who are unable to enroll in an impacted course on their home campus to enroll in online courses at other community colleges. The May Revision includes $20 million one-time Proposition 98 General Fund with the expectation that CCCs, through the online course exchange, will expand student access to online courses that can be counted towards their degrees.

Successful implementation of these efforts requires a strong and reliable technological infrastructure. In recognition of this, the May Revision also includes $5 million ongoing Proposition 98 General Fund and $7 million one-time Proposition 98 General Fund to support the Telecommunications and Technology Infrastructure Program, which will expand broadband capacity across campuses to ensure appropriate internet access is available for students, faculty, and community college administrators.

The Administration expects these efforts will improve student access to online courses, reduce student costs, and further the goal of timely completion.

California State University

The Governor's Budget expressed the urgent need to dramatically improve outcomes for CSU students. Of the students who started as freshmen in fall 2011 and enrolled in twelve or more units in their first term, 19 percent graduated within four years. (The average four-year graduation rate across universities to whom the CSU compares itself for compensation purposes is 25 percent.) The outcomes for those who are eligible for federal Pell Grants are even lower. 12 percent of Pell-eligible students graduate within four years, whereas 25 percent of their non-Pell-eligible peers graduate within that timeframe.

New Goals for CSU

In January 2015, the CSU Chancellor announced a new Graduation Initiative 2025, which set several systemwide targets for graduation rates to be achieved by 2025. These included a four-year graduation rate of 24 percent, a two-year transfer graduation rate of 35 percent, and a gap in the graduation rates of Pell-eligible students and non-Pell-eligible students of no greater than 5 percent. More recently, the Chancellor announced a goal of closing the achievement gap, but did not provide a timeline for doing so. The Chancellor's Office has indicated that University leaders will meet this summer to revise these goals.

The Administration views these initiatives as an opportunity for CSU to articulate more ambitious goals that would improve student success. These kinds of changes will require new ways of thinking about the roles of the state, the CSU Board of Trustees, the system office, and the campuses, and they will require CSU to depart from past practices.

To support these goals, the May Revision includes one-time $25 million General Fund (redirected from Middle Class Scholarship Program savings in 2015-16). The release of these funds would be contingent upon the Trustees articulating clear, coherent plans for the University as a whole and for each campus, that indicate the timeframe by which the system and campuses will (1) increase four-year graduation rates and two-year transfer graduation rates to at least the rates of other institutions and (2) increase the graduation rates for Pell-eligible students to at least the rates of their non-Pell-eligible peers. The Chancellor would present these plans for approval by the Trustees no later than their September 2016 meeting. This will provide time for campus presidents, faculty and students to provide suggestions. Thereafter, the Trustees would report to the Administration and the Legislature, at least annually, on implementation of these plans and progress toward these goals.

Expanding Existing Campus Successes

Many campus leaders are finding ways to improve outcomes for all students, and for Pell-eligible students in particular. The Administration believes the practices described below should be integrated into campus plans statewide to improve graduation rates.

Educational Plans

To help students find a path toward their degrees in a timely way, campuses should assist students immediately upon matriculation. All freshman entrants should be advised based on four-year plans, and transfer students should be advised based on two-year plans—and campuses should allocate resources to make those plans possible. Some campuses have been exploring new electronic advising tools to help students stay on track with their plans. Students at all campuses should have access to these tools to help them plan and better navigate course selection. In addition, the availability of online courses can help students make progress toward completion of their programs.

Use of Technology to Improve Learning

Recent CSU experience demonstrates that redesigning courses to improve the quality of instruction can improve student learning. In many cases, that is because technology allows students to participate more directly in courses, makes more engaging content available, and enables students to acquire instructional materials they would otherwise be unable to afford. The state established the California Open Education Resources Council, comprised of faculty leaders across segments, to collect open educational resources for at least 50 common lower-division courses. The California Open Online Library for Education now houses those materials. The Chancellor should encourage the use of these resources by providing faculty and lecturers who teach with open educational resources support in using the materials. The Chancellor should also target state funds being allocated for course redesign to those courses that use open educational resources.

Policy Reform

Campus leaders need the flexibility to innovate. The Chancellor should thoroughly review system policies—including funding allocations—to ensure they align with graduation goals endorsed by the Board of Trustees. In the meantime, the Chancellor should establish an expedited process that will allow campus leaders to seek exemptions to existing policies if those leaders provide a reasonable case that the changes would improve student success.

Student Success Network

Many campus leaders cite a need for better ways to learn from the successes and challenges that their colleagues at other campuses experience, and to have deeper conversations that are grounded in thorough analysis and research. The May Revision includes $1.1 million General Fund on an ongoing basis to support the CSU Student Success Network, which would be led by faculty, staff, and administrators from across the system committed to exploring new ways to improve outcomes for students and spreading effective practices more broadly. In support of this peer-to-peer approach, the funds would be administered by the Education Insights Center at CSU Sacramento.

University of California

The Governor's Budget continues the Administration's multi-year funding plan for the University, consistent with the agreement between the Governor and the UC President. The Administration is monitoring progress against the agreed-upon timeframes for the components of the agreement, and the May Revision provides updates on major activities.

Progress on the 2015 Agreement

As part of the agreement between the Governor and the UC President, UC is undertaking several new initiatives to improve transfer from the community colleges, pathways to a three-year degree, use of technology and data, and long-term financial sustainability. The 2015 Budget Act also added expectations related to enrollment. The following are recent milestones in that agreement:

- Undergraduate Enrollment—The 2015 Budget Act articulated the state's expectation for UC to enroll 5,000 more resident undergraduate students by 2016-17—compared to the number of resident undergraduate students enrolled in 2014-15—and made an additional $25 million General Fund available upon demonstration that it would meet the expectation. The President reported in April that the number of resident undergraduate students enrolled in 2016-17 will be at least 180,034—5,000 more than the number of resident undergraduate students enrolled in 2014-15. The May Revision, therefore, includes $25 million General Fund on an ongoing basis.
- Retirement Program—The 2015 Budget Act also appropriated $96 million General Fund to UC, contingent upon the Regents adopting a retirement program that limits pensionable compensation consistent with the limits specified in the

Public Employees' Pension Reform Act of 2013 (PEPRA). These funds count as debt payments under Proposition 2. At the board's meeting in March 2016, the Regents approved a retirement program that limits pensionable compensation consistent with the limits specified in PEPRA. The May Revision includes $171 million in 2016-17 for the same purpose.

- Community College Transfer—In March 2016, UC announced additional community college transfer pathways—which articulate the set of courses students can take to prepare for transfer into a particular major at any UC campus. There are now 21 such pathways. The agreement also expects campuses to begin enrolling at least one new transfer student for every two new freshmen they enroll by the 2017-18 academic year. To achieve the enrollment growth described above, all campuses would increase the number of transfer students enrolled. Based on information provided by the UC, four campuses will achieve the two-to-one goal in 2016-17.
- Three-Year Degree Pathways—To help more students achieve a degree in a timely way, each campus has articulated pathways for at least 10 majors that would allow students to graduate in three years or less. The agreement specifies that at least 5 percent of students should be on these pathways by the summer of 2017.

New Effort to Improve College Preparation

California's Local Control Funding Formula identifies, as an indicator of pupil achievement, the percentage of students who meet the requirements for entrance to UC and CSU. Completion of the "a-g" subject requirements—an important component of eligibility for the public universities—remains uneven across the state. Furthermore, too many students are identified as unprepared when they enter the state's colleges and universities and are required to take courses that do not count toward their degrees. Improving achievement will require efforts not only in schools, but across the state's higher education segments.

The May Revision includes $4 million General Fund on a one-time basis for a new A-G Success Initiative to make progress on this challenge. Scout is a UC program that provides free online classes and curriculum approved by the University to meet the "a-g" subject requirements—expanding options for schools to make college preparatory courses more accessible for all students. Scout currently offers 26 of these online classes. As part of the A-G Success Initiative, Scout would consult with schools to determine needs and add 45 more classes by January 2018.

Significant Adjustments

The following are significant adjustments proposed in the Budget.

California Community Colleges

- CCC Apportionments—A net increase of $12.2 million Proposition 98 General Fund to reflect a $41.5 million increase for a revised estimate of the City College of San Francisco's declining enrollment protection and a $29.3 million reduction to reflect a change in the cost-of-living adjustment from 0.47 percent down to 0.00 percent.

- Increased Operating Expenses—An increase of $75 million Proposition 98 General Fund to support increased community college operating expenses in areas such as employee benefits, facilities, professional development, converting faculty from part-time to full-time, and other general expenses.

- Apportionments Local Revenue Adjustment—An increase of up to $38.6 million Proposition 98 General Fund in 2015-16, provided on a contingency basis, for an anticipated shortfall in redevelopment agency property taxes for community college apportionments. Related language provides a mechanism to distribute up to $38.6 million based on a determination of property taxes reported for community colleges as of the annual principal apportionment certification in early February 2017. Any funds not needed to support the anticipated shortfall would become available for additional mandate debt payments.

- Online Education Initiative—An increase of $20 million one-time Proposition 98 General Fund to expedite and enhance the adaptation and development of online courses that will be available through the online course exchange.

- Telecommunications and Technology Infrastructure Program—An increase of $12 million Proposition 98 General Fund, of which $7 million is one-time, to expand broadband capacity across community college campuses to ensure appropriate internet access is available for students, faculty, and community college administrators.

- Adult Education Technical Assistance—An increase of $5 million Proposition 98 General Fund on a one-time basis to provide consortia with technical assistance, coordination, and capacity building assistance through the 2018-19 fiscal year.

- Equal Employment Opportunity Program—An increase of $2.3 million Employment Opportunity Fund to promote equal employment opportunities in hiring and promotion at community college districts.
- Full-Time Student Success Funding—An increase of $2.2 million Proposition 98 General Fund to reflect the inclusion of Cal Grant C recipients, and an increased estimate of eligible Cal Grant B students in 2016-17.
- Academic Senate Funding—An increase of $300,000 Proposition 98 General Fund for the Academic Senate of the California Community Colleges to develop, promote, and act upon policies in support of recent statewide community college programmatic efforts and initiatives focused on student success.
- Deferred Maintenance and Instructional Equipment—A decrease of $65.8 million Proposition 98 General Fund to reflect alternative spending priorities. This leaves $219.4 million in one-time Proposition 98 General Fund for deferred maintenance, instructional equipment, and specified water conservation projects. These funds are intended to protect investments previously made in facilities and to improve students' experience by investing in new instructional equipment.
- Mandate Debt Payments—An increase of $29.2 million one-time Proposition 98 General Fund to pay for outstanding mandate debt on a per full-time equivalent student basis to reduce mandate debt while providing districts with discretionary one-time funding for investments in local priorities.
- Categorical Program Cost-of-Living Adjustment—A decrease of $1.3 million Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 0.47 percent to 0.00 percent for the Disabled Student Programs and Services program, the Extended Opportunities Programs and Services program, the Special Services for CalWORKs Recipients program, and the Child Care Tax Bailout program.
- Apprenticeship Program Rate Adjustment—A decrease of $136,000 Proposition 98 General Fund to reflect a 0-percent cost-of-living adjustment applied to the hourly non-credit funding rate for the Community College and K-12 Apprenticeship programs.
- Proposition 39—The California Clean Energy Jobs Act was approved by voters in 2012 and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision increases the

amount of energy efficiency funds available to community colleges in 2016-17 by $4.1 million to $49.3 million to reflect increased revenue estimates.

- Local Property Tax Adjustment—An increase of $51.2 million Proposition 98 General Fund in 2016-17 as a result of decreased offsetting local property tax revenues.
- Student Enrollment Fee Adjustment—A decrease of $9.8 million Proposition 98 General Fund as a result of increased offsetting student enrollment fee revenues.
- Community College Mandated Programs Block Grant—A decrease of $134,000 Proposition 98 General Fund to align mandate block grant funding with the revised full-time equivalent student estimates.

California State University

- Funding for Graduation Plan—An increase of $25 million General Fund (from Middle Class Scholarship savings) on a one-time basis contingent upon the Trustees of the California State University adopting plans and timeframes for graduation rates that meet the state's expectations.
- Student Success Network—An increase of $1.1 million General Fund ongoing for support of the CSU Student Success Network.

University of California

- Funding for Enrollment Expectation—$25 million General Fund ongoing for increased resident enrollment.
- A-G Success Initiative—An increase of $4 million General Fund on a one-time basis for the development of high-quality, middle school and high school online classes and curriculum that satisfy the "a-g" subject requirements.

California Student Aid Commission

- Offset of Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements—An increase of $283 million in TANF reimbursements in 2016-17, which reduces the amount of General Fund needed for program costs. Combined with the TANF reimbursements included in the Governor's Budget, the May Revision offsets $1.1 billion in General Fund costs for Cal Grants with TANF reimbursements in 2016-17.

- Cal Grant Program Costs—A decrease of $50.9 million General Fund in 2015-16 and $101.6 million General Fund in 2016-17 to reflect revised cost estimates for the Cal Grant program.
- Middle Class Scholarship Program Costs—A decrease of $33.5 million General Fund in 2015-16 to account for savings for the Middle Class Scholarship Program. The statutory appropriation is $82 million; however, based on the number of awards offered this year, costs are not expected to exceed $48.5 million.
- Funding for Cal Grant B Access Award Supplement—An increase of $3.2 million College Access Tax Credit Fund in 2016-17. Combined with the funds included in the Governor's Budget, the May Revision includes a total of $5.1 million from the College Access Tax Credit Fund, which will fund a supplemental award of $22 for each student who receives a Cal Grant B Access Award.
- Loan Assumption Program Costs—A decrease of $2.1 million General Fund in 2015-16 and $2.4 million General Fund in 2016-17 to reflect revised estimates of costs for the Assumption Program of Loans for Education, the Graduation Assumption Program of Loans for Education, and the State Nursing Assumption Program of Loans for Education.
- Support for Existing Grant Delivery System—An increase of $2 million General Fund ($0.5 million ongoing) for upgrades to the existing Grant Delivery System identified in a recent security audit. The Commission is expected to reallocate resources to address any remaining issues.
- Support for Grant Delivery System Procurement Project Planning—A one-time increase of $396,000 General Fund for planning for the procurement of a new Grant Delivery System.

California State Library

- Improve Services—An increase of $505,000 General Fund for services, including publications, database subscriptions, and other resources.
- Increases in Facilities Rent—An increase of $56,000 General Fund for increases in rent for its facility in Sacramento.

Health and Human Services

The Health and Human Services Agency oversees departments and other state entities such as boards, commissions, councils, and offices that provide health and social services to California's vulnerable and at-risk residents.

The May Revision includes total funding of $141 billion ($33 billion General Fund and $108 billion other funds) for all programs overseen by this Agency, a decrease of $747 million General Fund compared to the Governor's Budget.

Department of Health Care Services

Medi-Cal, California's Medicaid program, is administered by the Department of Health Care Services (DHCS). Medi-Cal is a public health care coverage program that provides comprehensive health care services at no or low cost for low-income individuals. The federal government mandates basic services, including: physician services; family nurse practitioner services; nursing facility services; hospital inpatient and outpatient services; laboratory and radiology services; family planning; and early and periodic screening, diagnosis, and treatment services for children. In addition to these mandatory services, the state provides optional benefits such as outpatient drugs, home and community-based services, and medical equipment. DHCS also operates the California Children's Services and the Primary and Rural Health programs, and oversees county-operated community mental health and substance use disorder programs.

Significant Adjustments:

- Medi-Cal 2020 Waiver—The May Revision includes $2.2 billion in federal funds for the new Medi-Cal 2020 waiver. California and the federal government reached an agreement on the Section 1115 Waiver renewal that began on January 1, 2016. The waiver includes a number of initiatives to improve health care quality. Those initiatives include Public Hospital Redesign and Incentives in Medi-Cal, the Global Payment Program, Whole Person Care Pilots, and the Dental Transformation Initiative.

- Behavioral Health Treatment—The May Revision includes $180.2 million General Fund, an increase of $86.4 million, to provide federally required Behavioral Health Treatment services. The Medi-Cal costs have increased to reflect transitioning responsibility for the provision of these services to the Medi-Cal program from the state's Developmental Services system.

- Full-Scope Medi-Cal Coverage for Undocumented Children—The May Revision includes $188.2 million General Fund, an increase of $45.4 million, to provide full-scope benefits to 185,000 children. Chapter 18, Statutes of 2015 (SB 75), expands full-scope Medi-Cal benefits to undocumented children under 19 years of age. The provision of this benefit begins in May 2016.

- Newly Qualified Immigrant Benefits and Affordability Program—An increase of $31.8 million General Fund to reflect a delay in the implementation date to January 1, 2018. The program will enroll eligible beneficiaries in an Exchange Qualified Health Plan with premium and out-of-pocket payment assistance.

- Minimum Wage—An increase of $7.1 million General Fund to reflect the impact of the 50-cent increase in the state minimum hourly wage, effective January 1, 2017, pursuant to Chapter 4, Statutes of 2016 (SB 3).

- Medicaid Managed Care Regulations—An increase of $5 million General Fund and 38 positions to implement the federal regulations. In May 2016, the federal government published final regulations pertaining to Medicaid managed care programs, and published final regulations in November 2015 pertaining to Medicaid fee-for-service access standards and monitoring. The managed care regulations are related to beneficiary grievances, provider networks, program integrity, and financing, and there are several components of the regulations that could negatively impact California and result in General Fund costs in the hundreds of millions of dollars annually.

- Continuum of Care Reform—An increase of $6.4 million General Fund for county mental health costs associated with implementation of Continuum of Care Reform efforts pursuant to Chapter 773, Statutes of 2015 (AB 403), including participation in child and family teams, mental health assessments for children in foster care, and training for mental health providers.

- Residential Treatment Services—Decreased costs of $20.1 million General Fund, leaving a total of $12.3 million General Fund ($39.1 million total funds), for the implementation of residential treatment services. The revised funding reflects the time needed to obtain state, county, and federal approval of county implementation plans pursuant to the federal Drug Medi-Cal-Organized Delivery System Waiver approved in 2015.

- Institutional Deeming—An increase of $2.2 million ($1.1 million General Fund) to provide transition assistance to approximately 433 children currently enrolled in the Home and Community-Based Services Waiver for Persons with Developmental Disabilities. Under federal law, these children will likely lose their Medi-Cal eligibility with the transition of Behavioral Health Treatment from a waiver benefit to a state plan benefit in March 2017. The assistors will facilitate enrollment into appropriate, comprehensive health care coverage.

Health Care Reform Implementation

In 2013, California implemented significant portions of the Affordable Care Act. The Health Benefits Exchange has provided affordable health insurance, including plans subsidized with federally funded tax subsidies and products for small businesses, beginning January 1, 2014. The Medi-Cal program was expanded with simplified eligibility rules, and the optional expansion extended eligibility to adults without children, as well as parent and caretaker relatives with incomes up to 138 percent of the federal poverty level.

With these reforms, the Medi-Cal caseload will increase from 7.9 million in 2012-13 to a projected 14.1 million in 2016-17, covering over a third of the state's population. Beginning in 2017, the state assumes a 5-percent share of cost for the optional expansion population. By 2020-21, the federal share will have decreased to 90 percent and the state will pay 10 percent. The May Revision assumes costs of $16.2 billion ($819.5 million General Fund) in 2016-17 for the state's share of costs for the optional Medi-Cal expansion.

1991-92 State-Local Realignment Health Subaccount Redirection

Under the Affordable Care Act, county costs and responsibilities for indigent health care are decreasing as more individuals gain access to health care coverage. The state-based Medi-Cal expansion has resulted in indigent care costs previously paid by counties shifting to the state, contributing to significant increases in state costs.

Chapter 24, Statutes of 2013 (AB 85), modified the 1991 Realignment Local Revenue Fund distributions to capture and redirect savings counties are experiencing from the implementation of federal health care reform. These savings are reallocated to counties to pay an increased county contribution towards the costs of CalWORKs grants, which reduces state General Fund expenditures. County savings are estimated to be $749.9 million in 2015-16 and $643.4 million in 2016-17. However, actual county savings in 2013-14 were $177.4 million lower than estimated and the May Revision assumes reimbursement of this amount to counties in 2016-17.

Managed Care Organization Financing

The Governor called a special session in June 2015 to address a proposed tax on health plans. Chapter 2, Statutes of 2016, Second Extraordinary Session (SBX2 2), authorized a tax on the enrollment of Medi-Cal managed care plans and commercial health plans. This reduces General Fund spending in the Medi-Cal program by approximately $1.1 billion in the budget year, and more than $1.7 billion in 2017-18 and 2018-19. SBX2 2 also included reforms that reduced taxes paid by the health plan industry. The May Revision assumes a decrease in General Fund revenue of $300 million in the budget year to account for a reduction in insurance tax and corporation tax revenue from affected health plans.

Chapter 3, Statutes of 2016, Second Extraordinary Session (ABX2 1), included significant investments made possible by the managed care organization tax. These investments include:

- Developmental Services—$287 million in General Fund expenditures for various developmental services programs, including rate adjustments for community-based providers serving individuals with developmental disabilities.
- Retiree Health Prefunding—$240 million General Fund set aside in a trust fund to pay for future retiree health care benefits.

- Medi-Cal Rates—$135 million General Fund in the budget year for increased Medi-Cal rates for Intermediate Care Facilities for the Developmentally Disabled and forgiveness of recoupments for Distinct Part Nursing Facilities.
- UC PRIME—$2 million General Fund for the University of California, San Joaquin Valley Program in Medical Education.

Department of Social Services

The Department of Social Services serves, aids, and protects needy and vulnerable children and adults in ways that strengthen and preserve families, encourage personal responsibility, and foster independence. The Department's major programs include CalWORKs, CalFresh, In-Home Supportive Services (IHSS), Supplemental Security Income/State Supplementary Payment (SSI/SSP), Child Welfare Services, Community Care Licensing, and Disability Determination.

Significant Adjustments:

- Continuum of Care Reform—An increase of $59.9 million General Fund in 2016-17 for county child welfare agencies and probation departments to continue the implementation of the Continuum of Care reforms contained in Chapter 773, Statutes of 2015 (AB 403). The reforms emphasize home-based family care, improved access to services without having to change out-of-home placements to get those services, and an increased role of children, youth, and families in assessment and case planning. The measure establishes a core practice model to govern all services, whether delivered by a county or licensed provider organization, and provides currently required medically necessary mental health services to children regardless of their placement setting. Combined with funding in the Department of Health Care Services, the May Revision includes $127.3 million General Fund to implement the reforms.
- Restoration of IHSS 7-Percent Across-the-Board Reduction—An increase of $265.8 million General Fund to reflect restoration of the 7-percent reduction to IHSS. The Governor's Budget proposed funding this restoration using proceeds from the managed care organization tax. The restoration shall remain in effect until June 30, 2019, when the tax is scheduled to expire.
- IHSS Overtime Exemptions—Increases of $3.6 million General Fund in 2015-16 and $22.3 million General Fund in 2016-17 to reflect costs associated with exempting

providers who meet specified criteria from IHSS overtime restrictions enacted in Chapter 29, Statutes of 2014 (SB 855). Exemptions will be available for live-in family care providers who, as of January 31, 2016, reside in the home of two or more disabled minor or adult children or grandchildren for whom they provide services. A second type of exemption will be considered for recipients with extraordinary circumstances and granted on a case-by-case basis. Under either exemption, the maximum number of hours a provider may work cannot exceed 360 hours per month.

- IHSS Compliance with Fair Labor Standards Act—A decrease of $65.8 million General Fund in 2015-16 primarily resulting from the revised implementation schedule for the payment of overtime, travel and medical accompaniment to IHSS providers to comply with federal Fair Labor Standards Act rules and the provisions of SB 855.
- CalWORKs Grant Increase—Due to an increase in 1991-92 State-Local Realignment revenue projections, the May Revision includes a 1.4-percent increase to CalWORKs grants, effective October 1, 2016. The Child Poverty and Family Supplemental Support Subaccount of the Local Revenue Fund is projected to have a 2016-17 ending balance of $47.4 million. Of this amount, $35.4 million will be used to fund the first-year costs (9 months) of the grant increase, with the remainder carried forward to 2017-18 to help fund the full-year costs.
- Minimum Wage Increase—An increase in IHSS expenditures of $18.4 million General Fund and a decrease in CalWORKs expenditures of $6 million General Fund to reflect the impact of the 50-cent increase in the state minimum hourly wage, effective January 1, 2017, pursuant to Chapter 4, Statutes of 2016 (SB 3).
- Caseload-Related Adjustments—The May Revision reflects revised basic caseload and cost projections since the Governor's Budget. Major caseload-related adjustments include:
  - IHSS—General Fund increases of $131.7 million in 2015-16 and $183.1 million in 2016-17 to reflect increases in caseload growth, average hours per case, and average cost per case.
  - CalWORKs—An increase of $46.6 million General Fund and federal Temporary Assistance for Needy Families (TANF) block grant funds in 2015-16 and a decrease of $28.4 million General Fund and TANF in 2016-17 to reflect updated caseload and average cost per case projections.

- SSI/SSP—Decreases of $19.4 million in 2015-16 and $44 million in 2016-17 to reflect updated caseload and average cost per case projections. The May Revision continues to reflect a cost-of-living increase, effective January 1, 2017, to the SSP portion of the SSI/SSP grant equivalent to the increase in the California Necessities Index, which is 2.76 percent.

Department of State Hospitals

The Department of State Hospitals (DSH) administers the state mental health hospital system, the Forensic Conditional Release Program, the Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed patients.

Incompetent to Stand Trial Admissions

Over the past four years, DSH has experienced a significant increase in the number of Incompetent to Stand Trial (IST) referrals from local courts, with an annual growth rate of over 10 percent since 2013-14. In response, the department has activated 336 inpatient beds and 108 jail-based competency restoration beds. Despite these measures, referrals continue to outpace admissions and discharges and the pending placement list was over 450 individuals as of May 1, 2016. The May Revision proposes further expansion of both inpatient and jail-based beds, but this expansion will exhaust current capacity within state hospitals and cannot satisfy demand if referrals continue to grow. To address this continued growth, the Administration will continue to work with county partners, the Judicial Council, and stakeholders to find approaches to ameliorate the growth in referrals, explore additional ways to make the IST process more efficient, and examine opportunities for additional bed capacity through partnerships with counties. In the near term, the May Revision includes the proposals described below.

As discussed in the Governor's Budget, the Administration remains committed to working with Los Angeles County to address alternative ways to create a more collaborative state and local public safety system to achieve efficiencies. One possible approach is the creation of a joint use correctional treatment facility that could serve as a diversion program or housing for state and local inmates with high mental health or substance use disorder treatment needs. These offenders tend to drive significant costs for the criminal justice system. This new model of diversion and treatment would aim to break the cycle of crime and reduce costs, which is of particular importance for Los Angeles County given the County represents approximately one-third of inmates within the state prison system, and the County currently has approximately 135 offenders deemed incompetent to stand trial and awaiting placement in a state hospital. While the May Revision does not include a specific proposal to address this potential collaboration, the Administration will continue working with Los Angeles County and other interested counties on this effort.

Significant Adjustments:

- Jail-Based Competency Treatment Beds—The May Revision includes $2.7 million General Fund and 1 position for DSH to expand the jail-based competency treatment program by 25 beds and provide additional oversight of the restoration of competency program. With this request, and the additional 10 beds proposed in the Governor's Budget, DSH will support a total of 183 restoration of competency beds to serve incompetent to stand trial patients outside of the state hospitals, at a cost of approximately $22.6 million General Fund.
- Activation of State Hospital Beds—The May Revision includes an increase of $18.1 million General Fund and 175.5 positions to activate an additional 60 beds at Napa State Hospital and 36 beds at Metropolitan State Hospital. The activations of these available beds improve DSH's ability to address the immediate needs of pending placements.

Department of Developmental Services

The Department of Developmental Services (DDS) provides individuals with developmental disabilities a variety of services that allow them to live and work independently or in supported environments. California is the only state that provides developmental services as an individual entitlement. The state is in the process of closing all the state-operated developmental centers, except for the secure treatment area at the Porterville Developmental Center. By the end of 2016-17, DDS estimates it will serve approximately 303,000 individuals with developmental disabilities in the community and 847 individuals in state-operated developmental centers.

Developmental Center Closures

DDS carries out its responsibilities through 21 community-based, non-profit regional centers, 3 state-operated developmental centers, and 1 state-operated community facility.

As part of the closure activities at the Sonoma, Fairview, and Porterville (general treatment area) developmental centers, the May Revision includes language to: (1) extend special managed care provisions to Medi-Cal eligible individuals that are transitioning from developmental centers into the community; (2) provide an exemption to allow developmental center employees working at facilities slated for closure to go through the process of becoming community-based service providers; and (3) provide retention incentives for developmental center staff during the closure process to maintain services during the transition. The Administration will continue to work on developing an effective approach to encourage successful transition of the developmental center workforce to the private sector during the closure process.

Regional Center Services

The regional center system is projected to serve more than 300,000 individuals with developmental disabilities and their families in the budget year. Regional centers provide intake, assessment, eligibility determination, resource development, and case management services. The centers also work with the thousands of businesses and individuals providing developmental services in the community.

In addition to the Governor's Budget proposals totaling $80 million ($50 million General Fund) for targeted investments in the developmental services system, the May Revision reflects $287 million General Fund ($473.2 million total funds) in additional funding from Chapter 3, Statutes of 2016, Second Extraordinary Session (ABX2 1).

The May Revision proposes an additional $6.6 million General Fund in 2016-17 for regional center and DDS resources to implement changes authorized by ABX2 1. These resources will be used to oversee the implementation of cultural programs and competitive integrated employment activities, contract for a provider rate study, and report on adjustments to provider rates.

Significant Adjustments:

- Minimum Wage—An increase of $12 million General Fund to reflect the impact of the 50-cent increase in the state minimum hourly wage, effective January 1, 2017, pursuant to Chapter 4, Statutes of 2016 (SB 3).
- Behavioral Health Treatment—The May Revision includes a decrease of $75.8 million General Fund to reflect the transition of Behavioral Health Treatment services for regional center consumers that will now receive these services in the Medi-Cal program.

Emergency Medical Services Authority

The Emergency Medical Services Authority administers a system of coordinated emergency medical and disaster medical response. For 2016-17, the May Revision includes $36.1 million ($8.7 million General Fund) for the Authority.

In 2007, the State of California purchased three Mobile Field Hospitals with the intent to replace or augment acute hospital care capacity during catastrophic disasters. To date, the Mobile Field Hospitals have never been deployed. Working with other state agencies, and within existing resources, the Emergency Medical Services Authority proposes to redesign the Mobile Field Hospital program to modify and expand the potential uses of the equipment into general staging, stabilization and shelter capability. This could include alternate healthcare sites to provide low acuity care for triage and stabilization, command and staff shelters for incident command, and general or medical shelter facilities. This approach allows for flexible deployment to support a broad range of emergencies, including earthquakes, fires, floods, severe influenza, a novel virus epidemic, or bioterrorism. Additionally, the equipment may benefit other state agencies, including the Office of Emergency Services, the Military Department, and the Department of Public Health. The public health and medical response for health care surge capacity continues to be supported by federal, state and local resources that collectively will help to address the medical impacts of disasters and major events.

Housing and Local Government

This part of the Budget includes information related to housing and local governments.

Housing and Homelessness

California local governments have primary control over land use and housing-related decisions and can enact policies which either encourage or discourage housing construction. Because the state does not control land use decisions, its role in housing development is inherently limited to actions such as encouraging homeownership through its tax policy and helping to subsidize the development of affordable units. Of the approximately 13.9 million total homes and 4.3 million multifamily units in the state, approximately 3 percent of homes and 11 percent of rental units are affordable through legally binding restrictions. Of affordable units, approximately two-thirds receive funding from the state in the form of tax credits or subsidies from state departments. Because the state directly influences only this small segment of the housing market, efforts to increase housing construction depend largely on local land use decisions and market influences.

Local zoning and permitting decisions surrounding housing production in California have contributed to low inventories—even though demand has steadily increased. Discretionary local land use permitting and review processes have also lengthened the approval process and increased production costs, which have further limited increases to the housing supply. Further, community pressure and interest groups often use the current local review process to stall or stop housing projects, and these delays and denials place a strain on the state's housing supply by increasing project risks and costs. Consequently, the Department of Housing and Community Development (HCD) estimates that in the fourth Regional Housing Needs Assessment allocation period (2003 to 2014), housing unit permits (672,000) accounted for only 45 percent of projected need (1.48 million) to meet demand.

Today, approximately 1.5 million low-income California households pay more than half their income in rent, leading to a strained ability to pay for other household expenses. Furthermore, the lack of an adequate housing supply, which inflates housing costs overall, has helped to foster a high homeless population. In 2015, although California comprised 12 percent of the nation's population, it had 21 percent (115,700) of individuals experiencing homelessness in the United States. California has an even greater share of the chronically homeless, with over one-third of the nation's total. In addition to a number of social concerns, homelessness presents economic problems for cities, counties, and the state. Individuals experiencing chronic homelessness often have mental health issues and cycle among costly institutions, including inpatient hospitals, nursing homes, prisons and jails, and psychiatric treatment facilities. In 2009, a report on Los Angeles County noted that the public costs for people in supportive housing were one-fifth the public costs for people who were homeless ($605 versus $2,897 per month).

Although the state has a limited role in local land use decisions, it makes a sizable fiscal investment in housing. This investment must be maximized in a manner that will increase the pace of construction while reducing costs and avoiding delays. The state must target existing, or any new, housing resources to affordable housing developments that support state policies and objectives, like sustainable communities, transitional housing for former offenders, or supportive housing for homeless populations.

Funding for Affordable Housing

Historically, state funding for affordable housing and homelessness has been mostly limited to one-time General Fund appropriations, general obligation bond issuances, or the redirection of property taxes from local governments and K-14 schools to Redevelopment Agencies (RDAs).

The Housing and Emergency Shelter Trust Fund Act of 2002 (Proposition 46) and the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C) provided a total of $4.95 billion for various affordable housing and homelessness programs. While the funding provided by these bonds is virtually gone, the state must continue to pay debt service on the bonds for up to three decades—about $400 million General Fund in 2016-17 and a total of $10.7 billion over the life of the bonds. As of June 2015, HCD reported that this funding has assisted in the construction of 67,000 new units, the rehabilitation of 13,500 units, and the preservation of 1,600 units.

State spending has targeted low-income populations through the construction of multi-family rental units and supportive housing. Since 2002, the Multifamily Housing Program—the most efficient and flexible state program—awarded approximately $1 billion and produced 17,200 units, while leveraging $3.50 of public or private investment for every dollar of state funding. The state also awarded approximately $430 million for the Supportive Housing side of the Multifamily Housing Program, which provided 5,700 units and leveraged $2.64 per dollar of state investment. From 2011 to 2015, federal tax credit leveraging rates associated with the above state-funded programs were $133,000 per affordable unit and $170,000 per affordable supportive housing unit.

For 2016-17, the May Revision supports approximately $3.2 billion in state and federal funding and award authority for various affordable housing and homelessness programs across a number of state entities as shown in Figure SLA-01. The largest new source of funding is the Affordable Housing and Sustainable Communities Program, which receives 20 percent of Cap and Trade funds to target affordable housing funding in ways that also reduce greenhouse gas emissions.

Prior to the elimination of the state's approximately 400 RDAs pursuant to Chapter 5, Statutes of 2011 (ABx1 26), 20 percent of RDA property tax funding, which included money redirected from K-14 schools, was set aside for affordable housing at the local level. After accounting for the RDAs' current obligations, the dissolution of RDAs resulted in a reduction of available funding for affordable housing at the local level by approximately $400 million annually. However, from 2011-12 to 2014-15, approximately $3 billion in property tax revenue has been returned to cities and counties as general purpose revenues, which includes the cities' and counties' share of unencumbered funds returned from the Low and Moderate Income Housing Funds. The May Revision estimates that in 2015-16 and 2016-17 combined, cities and counties will receive more than $1.3 billion in property tax revenue because of the dissolution of RDAs. Local governments continue to have complete discretion on how this money can be spent, including on affordable housing and homelessness.

Successor agencies to the RDAs have also reported outstanding loan balances due to cities and counties of $633 million, of which 20 percent ($126 million) of the loan

Figure SLA-01

2016-17 Affordable Housing and Homelessness Funding

(Dollars in Millions)

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

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

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

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

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

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

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

repayments received must be transferred to the Low and Moderate Income Housing Asset Funds administered by the housing successor entities. In 2016-17, the amount to be transferred is estimated to be more than $10 million. Additionally, successor agencies have reported outstanding loans that were due to the Low and Moderate Income Housing Funds totaling $424 million, which will now be repaid to the Low and Moderate Income Housing Asset Funds. In 2016-17, these repayments are estimated to be $98 million. Furthermore, with the passage of Chapter 325, Statutes of 2015 (SB 107), successor housing entities of the former RDAs may now use the estimated $170 million in bond proceeds issued from January 1, 2011, through June 28, 2011, for affordable housing purposes.

Construction Costs and Approval Process Reduces Impact of Funding Investment

Despite the state's sizeable investment in housing, the number of new units developed continues to be very low when compared to the demand for housing. Development costs and the local review process are barriers that reduce the number of units that can be developed.

The average total development cost was $332,000 per unit for new construction projects that received housing tax credits from 2011 through 2015. Figure SLA-02 demonstrates that development costs per unit vary greatly across the state, from $207,000 in Kings and Tulare counties to nearly $600,000 in San Francisco.

Land costs, accounting for an average of 12 percent of new construction costs, typically cannot be influenced by governments. Yet other areas, such as streamlining local reviews, present a significant opportunity for savings. The 2014 Affordable Housing Cost Study found that local opposition increased project costs by 5 percent, and project changes due to local design and review increased project costs by 7 percent. The state's investment must incorporate policies to control development costs, given the high cost of housing construction.

Housing Tools

In addition to direct subsidies, the state influences affordable housing decisions by providing local governments with tools to help fulfill their housing priorities and responsibilities. A number of measures passed by the Legislature and signed by

Figure SLA-02

2011-2015 Affordable Housing Construction by County[1]

(Dollars in Thousands)

	Cost Per Unit
San Francisco	$591
San Mateo	442
Santa Cruz	436
Alameda & Contra Costa	418
Santa Clara	405
Ventura	400
Los Angeles	372
Napa & Sonoma	356
San Diego	350
Orange	340
San Luis Obispo	335
Solano & Yolo	312
El Dorado, Nevada & Placer[2]	311
Monterey & San Benito	310
San Bernardino	298
Sacramento	287
Santa Barbara	283
Imperial & Riverside	281
San Joaquin[2]	269
Colusa & Lake	261
Butte, Glenn, Sutter & Yuba	256
Kern	255
Shasta[2]	255
Madera, Merced & Stanislaus	244
Del Norte, Humboldt & Mendocino	237
Fresno	212
Kings & Tulare	207
STATEWIDE	**$332**

[1] Reflects all new construction projects for counties receiving tax credits from the Tax Credit Allocation Committee. Some projects include total development costs, while others exclude land cost.

[2] Figures for counties with fewer affordable housing projects were subject to a small sample size.

the Governor in recent years that allow local governments to invest in housing and other infrastructure while also reducing development costs to facilitate construction include:

- Enhanced Infrastructure Financing Districts—Chapter 785, Statutes of 2014 (SB 628), allows cities and counties to create an Enhanced Infrastructure Financing

District that utilizes property taxes and other available funding for various types of projects including low and moderate income housing projects.

- Community Revitalization and Investment Authorities—Chapter 319, Statutes of 2015 (AB 2), allows specified disadvantaged areas of California to create a Community Revitalization Investment Authority that utilizes property taxes and other available funding for various types of projects including affordable housing.
- Planning and Zoning Density Bonuses—Chapter 699, Statutes of 2015 (AB 744), reduces minimum parking requirements for developers who receive a density bonus for projects that meet specified criteria.
- Alternative CEQA Analysis—Chapter 386, Statutes of 2013 (SB 743), provides an alternative approach for CEQA analysis of transportation impacts of transit-oriented development and new exemptions for certain projects.

While the full impact of these recently passed measures is unknown, the Administration is committed to examining other opportunities surrounding housing and its affordability. To aid this effort, HCD will release the 2025 Statewide Housing Plan in the summer of 2016. This plan will frame California's housing challenges and opportunities and will analyze potential tools, resources, and state actions needed to address housing undersupply and affordability. Over the course of the summer and fall, the Administration intends to use this plan to foster a robust discussion around new approaches and opportunities to address the challenges of affordable housing.

Proposals to Reduce Housing Costs

The state's housing affordability and homelessness problems are long-standing, and solutions will not be easy. Ultimately, policy changes that will increase the housing supply will be most effective at reducing housing costs.

To this end, the Administration proposes legislation requiring ministerial, "by-right" land use entitlement provisions for multifamily infill housing developments that include an affordable housing component. This would help to restrain development costs, improve the pace of housing production by increasing certainty and shortening the local entitlement process, and encourage an increase in housing supply. Under the proposed legislation, a local government could not require a conditional use permit, planned unit development permit, or other discretionary local government review or approval for qualifying developments that include affordable housing, provided they are consistent with objective general plan and zoning standards and, where applicable, are subject to mitigating measures to address potential environmental harm. It is counterproductive to continue providing funding for housing under a system which slows down approvals in areas already vetted and zoned for housing, which only delays development and increases costs.

The Administration is also supportive of other initiatives to increase housing supply where such initiatives do not create a state reimbursable mandate. This includes using inventory such as accessory dwelling units (additional living quarters on single-family lots that are independent of the primary dwelling unit) and greater clarity on the use of the Density Bonus Law, which requires local governments to allow more total units in a project than otherwise permitted by existing zoning to promote the feasibility of affordable housing. Policies can increase the availability of accessory dwelling units with expanded ministerial approval, shortened permitting timelines, reduced duplicative fees, and relaxed parking requirements, consistent with the principles identified by SB 1069 (2016). The state can further increase supply by eliminating overly burdensome requirements for accessory dwelling units identified by AB 2299 (2016), such as passageways to public streets and setbacks of five feet from lot lines. Additionally, increased use of the Density Bonus Law can prove greater certainty to developers through such amendments as proposed in AB 2501 (2016).

Finally, the May Revision proposes sensible changes in law to further the California Housing Finance Agency's (CalHFA) goal of helping more families become first-time homebuyers by combining remaining funding totaling $176.5 million from multiple downpayment assistance programs into the MyHOME Program.

Funding for Mental Health-Focused Housing Assistance

There is increasing evidence that demonstrates the effectiveness of interventions such as rapid rehousing and permanent supportive housing in addressing chronic homelessness. The creation of a $35 million housing program within CalWORKs over the last two years, CalHFA's Special Needs Housing Program established this year, and the new Emergency Solutions Grant regulations recently promulgated by HCD are using this approach. Building upon these current efforts, the May Revision endorses the Senate's concept of a $2 billion bond of a portion of future Proposition 63 mental health revenues. This funding would enable HCD to develop and administer homelessness and affordable housing programs through a Mental Health Services Act-Supportive Housing Program and Tenant-Based Rental Assistance Program, with a particular focus on chronic homelessness. The May Revision proposes first-year funding of $267 million from the bond proceeds.

Community-Based Transitional Housing Program

The Governor's Budget proposed a $25 million siting grant program to encourage local communities to support housing that provides treatment and reentry programming to offenders from the criminal justice system. Local governments, which have primary control over land use, zoning and permitting, may be understandably reluctant to expand housing for ex-offenders, yet it is in everyone's interest to help this population transition into productive roles in their communities. The Administration convened a series of meetings in recent months with stakeholders to develop a framework for rewarding communities that agree to issue new, long-term permits for hard-to-site facilities. The May Revision includes statutory language to implement this grant program. Significant components of the Community-Based Transitional Housing Program include:

- Additional funds to local communities that site, for a minimum of 10 years, new transitional housing and supportive services for offenders released from state prison or county jail.
- A requirement that a portion of the funds be used by the city or county to increase public safety around the facility and improve communication with neighbors.
- A requirement that grant funding be shared with non-profit facility operators to support rehabilitative services, security, and community outreach.
- A competitive application process that will protect existing permitted facilities, examine the current concentration of permitted facilities in the community, review the past performance of the facility operator, and give priority to cities and counties that leverage or provide other funding for the facility.

Redevelopment Agencies

The winding down of the state's former redevelopment agencies (RDAs) continues to be a priority for the Administration. Chapter 5, Statutes of 2011 (ABx1 26), eliminated the state's approximately 400 RDAs and replaced them with locally organized successor agencies that are tasked with retiring the former RDAs' outstanding debts and other legal obligations. The Administration is currently in the process of implementing Chapter 325, Statutes of 2015 (SB 107), which made numerous changes to the dissolution process in 2016. The elimination of RDAs allows local governments to protect core public services and priorities by returning property tax money to cities, counties, special districts, and K-14 schools.

The May Revision estimates that cities will receive an additional $673 million in general purpose revenues in 2015-16 and 2016-17 combined, with counties receiving $710 million and special districts $316 million. It is estimated that additional ongoing property tax revenues of more than $3.2 billion will be distributed to cities, counties, and special districts by 2019-20. Additionally, the May Revision estimates that Proposition 98 General Fund savings resulting from the dissolution of RDAs will be $1.3 billion in 2016-17.

Public Safety

The May Revision includes the following changes related to California's correctional system and public safety.

Department of Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation incarcerates the most serious and violent felons, supervises them when they are released on parole, and provides rehabilitation programs to help them reintegrate into the community. The Department provides safe and secure detention facilities and necessary support services to inmates, including food, clothing, academic and vocational training, as well as health care services.

The May Revision includes $10.6 billion ($10.3 billion General Fund and $248 million other funds) for the operations of the Department in 2016-17. Including capital outlay, General Fund spending for the Department represents 8.6 percent of total General Fund spending, compared to a peak of 11.4 percent in 2011-12.

Compared to the Governor's Budget projections, changes in the adult inmate and parole population have resulted in a decrease of $11.6 million General Fund in 2015-16 and $9.8 million General Fund in 2016-17. The revised average daily population projections for adult inmates are 128,259 in the current year and 128,821 in the budget year, an increase of 578 inmates in 2015-16 and a decrease of 13 inmates in 2016-17. The revised average daily parolee population projection is 43,976 in the current year and 42,601 in the budget year, an increase of 16 and 30 parolees, respectively.

Changes in the juvenile population have resulted in a decrease of $493,000 General Fund in 2015-16 and $259,000 General Fund in 2016-17 since the Governor's Budget estimate. The revised average daily population projections for wards are 702 in the current year and 709 in the budget year, which is a decrease of 12 wards in the current year and 10 wards in the budget year.

Additional Investments to Support Inmate Rehabilitation and Reentry

The May Revision includes reductions in non-rehabilitative program areas and the savings are redirected to the Department's core rehabilitative mission. Specifically, $24.5 million General Fund, of which $3 million is from Proposition 98 funds, is proposed to expand, enhance, and create programming opportunities for state prison inmates. This funding builds upon the nearly $60 million included in the Governor's Budget to support long-term offenders, community reentry programs, and the expansion of in-prison substance use disorder treatment.

To measure the success of programs, the Department will evaluate in-custody and community programs for effectiveness, compliance with national best practices, and cost benefits. To this end, an April 1 Finance Letter included $4.5 million General Fund to allow the Department to further develop an information technology solution to improve its ability to track specific outcomes. These outcomes will help the Department track an offender's rehabilitative life cycle and begin implementing performance-based contracting for rehabilitative services, which help reduce recidivism. In addition, the Department is partnering with the Pew-MacArthur Results First Initiative to engage in a large-scale evaluation of the programs offered to inmates and parolees to best identify which programs are cost-effective and successful, and to prioritize and expand on effective evidence-based programs based on this analysis. Together, these efforts will inform the future of rehabilitative programs and services to support state inmates and parolees.

The May Revision includes the following:

- eReader Community College Content ($3 million Proposition 98 General Fund) —The Department is currently using approximately 7,500 eReaders to provide inmates enrolled in community colleges with access to textbook content. This funding will allow inmates to continue accessing these materials through eReaders and open educational resources.

- Internet Protocol Television Integration Maintenance and Operations Support ($3.7 million)—These resources will enable the Department to create the necessary infrastructure at each prison to support a television network to deliver rehabilitative programming to more inmates. Ongoing resources will allow the Department to support the infrastructure and develop additional program content.
- Cognitive Behavioral Therapy ($2.2 million)—Expands Cognitive Behavioral Therapy programs currently offered at 13 reentry hubs to all institutions. This expansion will provide more inmates an opportunity to participate in rehabilitative programs, such as criminal thinking, anger management, and family relations.
- Substance Use Disorder Treatment ($3.7 million)—This proposal adds 950 substance use disorder treatment slots to existing programs, thereby allowing the Department to serve more inmates identified as having a substance use disorder.
- Career Technical Education Programs ($2.3 million)—Adds 12 career technical education programs statewide to reduce the current waiting lists at institutions that have available classroom space to support these programs.
- Arts in Corrections ($4 million)—The Arts in Corrections program is currently available at 19 institutions through a partnership with the California Arts Council. This proposal expands the program to all institutions to provide more inmates with an opportunity to participate in programs that have proven successful in changing behavior.
- Innovative Programming Grants ($3.1 million)—Continues one-time funding to expand non-profit programs that have demonstrated success, and focus on offender responsibility and restorative justice principles to prisons with fewer volunteer programs available.
- Third Watch Overtime ($2.5 million)—Provides funding for custody coverage on third watch to alleviate program space constraints on second watch.

The May Revision also expands on the April 1 Finance Letter that requests $4 million General Fund to provide secured internet access for inmates in certain career technical education programs that require online access for inmates to obtain certification. The secured internet access will be provided at all institutions for classroom coursework, real-time shop exercises, and certification exams. The May Revision commits $10.6 million in 2017-18 and $3.3 million beginning in 2018-19 to expand the secured internet access to all career technical education courses consistent with the approved

Feasibility Study Report for this project. This technology upgrade will improve the Department's ability to provide offenders with a marketable trade that improves opportunities for employment upon release.

These program investments provide the Department an opportunity to operationalize its rehabilitative vision, which includes continuing to refine, enhance, and implement programs that address individual criminogenic needs, reduce recidivism, and transition offenders into contributing members of society.

Leadership Training

The May Revision includes $4 million for the Department to increase leadership training efforts and evaluate its current workforce to create a succession management plan. Training efforts will include basic and advanced supervisory training for both custody and non-custody first and second-line supervisors, and leadership training for supervisory staff, mid-level managers, and executive management and wardens.

The Department has a backlog of over 7,000 supervisors requiring mandated supervisory training. These resources will allow the Department to eliminate this backlog by 2017-18 and meet the training needs of newly promoted staff over that time.

Through contract funding, the Department will develop partnerships with the academic community to deliver training that will improve the knowledge and skills of existing executive management while also preparing supervisory and managerial staff to assume higher-level executive positions.

The Department will partner with the California Department of Human Resources to implement a management succession planning initiative consistent with overall civil service improvement reforms.

Electronic Health Record System

The May Revision includes an increase of $35.9 million General Fund in 2016-17 to address issues identified by the Receiver during implementation of the new electronic health record system and to add functionality to the system to include dental patient and scheduling information. The May Revision proposal commits $80.6 million over the next three years for this purpose, and ongoing funding of $5.8 million. Overall project costs are now estimated to be close to $350 million, most of which has been absorbed within the Receiver's Medical Program. Upon full implementation, the electronic health record system is expected to improve patient care.

Proposition 47

Proposition 47 requires misdemeanor rather than felony sentencing for certain property and drug crimes, and permits inmates previously sentenced for these reclassified crimes to petition for resentencing. Based on spring projections, Proposition 47 is expected to reduce the inmate population by 5,247 in 2015-16. This is an increase of 535 over the 4,712 estimated in the Governor's Budget.

Proposition 47 requires that state savings resulting from the proposition be transferred into a new fund, the Safe Neighborhoods and Schools Fund. The new fund will be used to reduce truancy and support drop-out prevention programs in K-12 schools, increase victim services grants, and support mental health and substance use disorder treatment services. Pursuant to the proposition, funds will be allocated as displayed in Figure SAF-01. The first transfer of state savings to the Safe Neighborhoods and Schools Fund will occur in 2016-17 after the Department of Finance calculates savings pursuant to the proposition.

Figure SAF-01

Proposition 47 Estimated Allocation

Department	*Purpose*	*Percentage*	*2016-17 Estimated Allocation*
Board of State and Community Corrections	Mental Health Treatment Substance Use Disorder Treatment Diversion Programs	65%	$25,642,000
State Department of Education	Improve Outcomes for K-12 Students Reduce Truancy Support Students at Risk of Dropping Out of School or who are Victims of Crime	25%	$9,862,000
California Victim Compensation and Government Claims Board	Support Trauma Recovery Centers that Serve Crime Victims	10%	$3,945,000
Total		100%	$39,449,000

The Department of Finance currently estimates net savings of $39.4 million when comparing 2015-16 to 2013-14, which is an increase of $10.2 million compared to the estimate in the Governor's Budget. This estimate assumes savings from a reduction in the state's adult inmate population, and increased costs due to a temporary increase in the parole population and trial court workload associated with fewer felony filings and more misdemeanor filings, and the number of offenders resentenced and released from the Department of State Hospitals. Ongoing savings are now expected to be approximately $62.6 million.

In addition to the funding made available through Proposition 47, the state has made significant investments in prevention programs and transitional services to support offenders in the criminal justice system, which are crucial to offenders' success in the community. Specifically, the state has expanded substance use disorder treatment, which includes intensive outpatient services and can include residential treatment. The state is also pre-enrolling state inmates into Medi-Cal prior to release, which makes them immediately eligible for these services upon release. The Department is estimated to have approximately 42,600 offenders on active parole in 2016-17 and approximately 85 percent of them will be Medi-Cal eligible. Additionally, the state has made other investments to support the criminal justice population through Mentally Ill Offender Crime Reduction Grants, Collaborative Court Programs, Community Recidivism Reduction Grants, local Workforce Investment Boards that serve the reentry population, and Social Innovation Bonds that promote recidivism reduction and housing for former felons.

Transportation

The Transportation Agency is responsible for developing and coordinating the policies and programs of the state's transportation entities to improve the mobility, safety, and environmental sustainability of California's transportation system. The Department of Transportation (Caltrans) designs and oversees the construction of state highways, operates and maintains the highway system, operates three intercity passenger rail routes (nearly 900 miles of track), and provides funding for local transportation projects. Caltrans maintains 50,000 lane miles of state and federal highways and nearly 13,000 state-owned bridges, and inspects more than 400 public-use and special-use airports and heliports.

California continues to face considerable challenges in funding critical maintenance and repair of its core transportation infrastructure—state highways, local roads, and bridges. Over the last decade, transportation funding has been directed primarily to decreasing traffic congestion, expediting goods movement, funding local streets and roads projects, and increasing transit facilities. While the repair, maintenance, and efficient operation of the state's highway system are important to California's continued economic growth, current resources do not sufficiently fund the system's annual maintenance and repair needs. Of the $8 billion in annual highway repair needs, the current fuel excise tax revenues are only sufficient to fund $2.3 billion, leaving $5.7 billion in unfunded repairs each year based on recent assessments of the state's deferred maintenance.

The Governor's Budget outlined a package of additional funding for state and local transportation priorities along with key program reforms. The package includes a combination of new revenues, additional investments of Cap and Trade auction proceeds, accelerated loan repayments, Caltrans efficiencies and streamlined project delivery, accountability measures, and constitutional protections for the new revenues. The proposed new revenues are split evenly between state and local transportation priorities, and the ten-year funding plan provides a total of $36 billion for transportation with an emphasis on a "fix-it first" strategy that focuses on repairing and maintaining the existing transportation infrastructure. It also includes significant investments in public transit. Specifically, the proposal includes annualized resources as follows:

- Road Improvement Charge—$2 billion from a new $65 fee on all vehicles, including hybrids and electrics.
- Stabilize Gasoline Excise Tax—$500 million by setting the gasoline excise tax beginning in 2017-18 at the historical average of 18 cents and eliminating the current annual adjustments. The broader gasoline tax would then be adjusted annually for inflation to maintain purchasing power.
- Diesel Excise Tax—$500 million from an 11-cent increase in the diesel excise tax beginning in 2017-18. This tax would also be adjusted annually for inflation to maintain purchasing power.
- Cap and Trade—$500 million in additional Cap and Trade proceeds.
- Caltrans Efficiencies—$100 million in cost-saving reforms.
- Accelerated Loan Repayments—$879 million in loan repayments over the next four years to be used for the Transit and Intercity Rail Capital Program, trade corridor improvements, and repairs on local roads and the state highway system. The Legislature has already adopted the first year's repayment of $173 million.

Over the next ten years, the $36 billion transportation package will provide $16.2 billion for highway repairs and maintenance, and invest $2.3 billion in the state's trade corridors. Local roads will receive more than $13.5 billion in new funding. Transit and intercity rail will receive over $4 billion in additional funding. Because the state's disadvantaged communities are often located in areas affected by poor air quality, a minimum of $2 billion (50 percent) of these transit and rail funds will be spent on projects that benefit these communities.

In addition to accelerated loan repayments of $173 million already adopted by the Legislature, the Governor's Budget reflected partial first-year resources from the transportation package of nearly $1.6 billion, which will be distributed as follows:

- Local Streets and Roads—An increase of $342 million in Shared Revenues to be allocated by the Controller to cities and counties for local road maintenance according to existing statutory formulas.
- Low Carbon Road Program—$100 million Cap and Trade for Caltrans to implement a new Low Carbon Road Program for local projects that encourage active transportation such as bicycling and walking, and other carbon-reducing road investments, with at least 50 percent of the funds directed to benefit disadvantaged communities.
- Transit and Intercity Rail Capital Program—An increase of $400 million Cap and Trade for transit capital investments that provide greenhouse gas reductions, with at least 50 percent of the funds directed to benefit disadvantaged communities.
- Highway Repairs and Maintenance—An increase of $510 million for Caltrans to fund repairs and maintenance on the state highway system.
- Trade Corridor Improvements—An increase of $200 million for Caltrans to fund projects along the state's major trade corridors, providing ongoing funding for a program originally established with $2 billion in one-time Proposition 1B bond funding. Trade corridors will also receive additional federal funding as described below as part of the May Revision.

In addition to new funding, the Governor's transportation funding package includes language that would eliminate unpredictable fluctuations in fuel tax revenues that have occurred in recent years. These changes in revenue make it difficult to plan transportation projects at both the state and local level. Due to these fluctuations, the California Transportation Commission and local governments are currently faced with the difficult task of identifying over $750 million in transportation projects to be defunded before the end of the fiscal year.

May Revision Proposal

The May Revision reflects the availability of federal funds that would provide additional funding for trade corridor improvements over the next five years.

- Fixing America's Surface Transportation Act—The new Fixing America's Surface Transportation (FAST) Act provides a five-year federal authorization of highway, transit, safety, and rail programs. The FAST Act allocates $582 million over the five years to California through the new National Highway Freight Program funding formula. Additionally, California is eligible to receive a portion of $900 million annually for Fostering Advancements in Shipping and Transportation of the Long-term Achievement of National Efficiencies (FASTLANE) competitive grants. FASTLANE grants can be applied to up to 60 percent of Nationally Significant Freight and Highway Projects program costs, with the remaining funds from state, local, or other federal funding sources. The May Revision includes provisional language which makes other state and federal funding available as a match for the remaining 40 percent. Caltrans proposes expending the formula funding pursuant to the Trade Corridor Improvement Fund Guidelines. The California Transportation Commission will allocate half of the funding to corridor-based projects proposed by local agencies and half to projects of statewide significance proposed by Caltrans.

Drought Resiliency

The years from 2012 to 2015 were the driest four consecutive years on record in California. The winter of 2015-16 brought welcome storms to Northern California, but the southern half of the state remains dry. Although the state's major northern reservoirs—Shasta, Oroville, and Folsom—all have higher-than-average storage levels for this time of year, storage in southern state reservoirs continues to lag. San Luis Reservoir—a key supplier to urban Southern California and the San Joaquin Valley—holds only half its average storage this time of year, and less than it held a year ago. These conditions serve as another reminder that it will take more than one wet year to erase the impacts of a multi-year drought that include dry wells in rural communities, fallowed farmland, heightened wildfire risks, and degradation of important ecosystems.

The California Water Action Plan, a roadmap to sustainable water management, guides the state's emergency drought response and includes a long-term commitment to making conservation a way of life, improving groundwater sustainability, and managing and preparing for dry periods.

Emergency Drought Response

The Governor's Budget proposed an additional $323.1 million to continue the state's emergency response to the drought, with the expectation that the Administration would continue to monitor and evaluate statewide drought conditions through the winter months and reevaluate budget-year needs. The May Revision proposes an additional $11.4 million, for a total of $334.5 million, for emergency drought response, based on current drought conditions (see Figure DRT-01).

Figure DRT-01
Emergency Drought Response
(Dollars in Millions)

Investment Category	*Department*	*Program*	*Amount*
Protecting Water Supplies	Department of Water Resources	Local Assistance for Small Communities	$10.0
	Water Board	Water Curtailment	$5.4
	Water Board	Emergency Drinking Water Projects	$16.0
Water Conservation	Department of Water Resources	Urban Water Conservation & Save Our Water Campaign	$12.0
	Energy Commission	Rebates for Appliances	$30.0
	Energy Commission	Water and Energy Technology Program	$30.0
	Department of Food and Agriculture	Agricultural Water Conservation	$20.0
Emergency Response	Department of Forestry and Fire Protection	Enhanced Fire Protection	$87.8
	Department of Forestry and Fire Protection	Tree Mortality	$11.0
	Department of Water Resources	Drought Management and Response	$12.0
	Department of Fish and Wildlife	Protection of Fish and Wildlife	$13.5
	Department of Fish and Wildlife	Delta Smelt Management Strategy	$4.2
	Department of Social Services	Drought Food Assistance	$18.4
	Office of Emergency Services	California Disaster Assistance Act	$52.7
	Office of Emergency Services	State Operations Center	$4.0
	Department of Community Services and Development	Farmworker Assistance	$7.5
Total			**$334.5**

Tree Mortality

Aerial surveys show an estimated 29 million trees have died as a result of the drought and effects of bark beetle infestation. This is an increase of more than 800 percent from 2014. These dead and dying trees make forests more susceptible to destructive wildfires and pose public safety risks from falling trees for residents living in rural, forested communities. The Department of Forestry and Fire Protection (CAL FIRE) has already identified Kern, Fresno, Madera, Mariposa, Tulare, and Tuolumne counties as high hazard zones.

In October 2015, the Governor issued an emergency declaration directing state and local entities, as well as utilities, to remove dead and dying trees that threaten power lines, roads, structures, and critical community infrastructure.

Significant Adjustments:

- Tree Removal—A one-time increase of $11 million General Fund to CAL FIRE to assist in the removal and disposal of trees in high hazard areas. This includes:
    - $6 million for grants to local entities, including local governments, special districts, fire districts, local conservation corps, tribal entities and fire safe councils, and funding for the California Conservation Corps to provide support for local efforts to remove hazardous trees that pose a threat to public health and safety.
    - $5 million to support additional miscellaneous equipment and personnel overtime, including foresters, hand crews, engine companies, and heavy equipment operators, for hazardous tree removal and fuels reduction efforts.
    - To accelerate the utilization of biomass materials for energy production in high hazard fire zones, legislation is proposed to allow small biomass facilities to defer certain system interconnection costs.

The May Revision also includes an additional $30 million for the Office of Emergency Services to provide assistance to counties through the California Disaster Assistance Act, which could be used to assist counties with tree mortality.

Delta Smelt

Delta smelt have experienced extremely poor habitat conditions during the last four years of unprecedented drought. Consequently, populations of smelt are at historic lows, and the scientific community has begun to assess the viability of the species. Delta smelt function as an indicator species for the overall health of the Delta's ecosystem. This winter's increase in rainfall, the state's existing aquatic weed control program, and recent advances in non-lethal means for monitoring Delta smelt provide an opportunity to accelerate habitat improvement and aggressively reduce other stressors for Delta smelt. The May Revision proposes $4.2 million General Fund on a one-time basis to benefit Delta smelt.

Significant Adjustments:

- Habitat Restoration and Food Production—An increase of $2 million General Fund for: (1) an adaptive management pilot project to promote food production where Delta smelt are known to occur, and (2) a restoration design plan to restore intertidal habitat near the confluence of the Sacramento and San Joaquin rivers. Delta smelt remain stressed due to insufficient transport of food to downstream areas inhabited by the smelt. Habitat restoration that converts shallow water habitat to intertidal elevations and modifies tidal circulations to restore historic tidal channel patterns can reduce invasive aquatic weeds, reduce predation, and improve food webs in the western Delta.
- Enhancing Aquatic Weed Control—An increase of $1.8 million General Fund to complete Delta-wide mapping of aquatic weeds to increase weed control in critical Delta smelt areas, and to assess the effectiveness of such control action in improving habitat quality. Aquatic weeds adversely impact smelt habitat by decreasing turbidity and increasing predator habitat. These weeds also restrict boating on waterways.
- Modern Monitoring and Targeted Studies—An increase of $400,000 General Fund for: (1) development of non-lethal monitoring of Delta smelt distribution, and (2) a pilot project using new technologies for turbidity monitoring to further refine data on smelt location and movement during periods of conflict with water pumps. Monitoring for distribution patterns and population estimates is essential for species conservation. Modernizing monitoring through "environmental DNA" and "Smelt Cam" technologies improves data collection and reduces impacts to the fish. Smarter data collection can be linked with targeted research to better inform management during high-conflict periods such as when winter storms and associated turbidity increase the chance of smelt movement towards the water pumps.

Other Adjustments

- Salinity Barriers—A decrease of $42 million General Fund to reflect that removal of salinity barriers in the Delta will not be needed in the fall of 2016, and an extension of $31 million in existing bond funds to install barriers in the spring of 2017, if necessary.

- Local Assistance for Small Communities—An increase of $5 million General Fund for the Department of Water Resources to provide emergency drinking water support for small communities, including addressing private wells. Combined with the $5 million already included in the Governor's Budget, a total of $10 million will be available for this purpose.
- Enhanced Fire Protection—An increase of $10.4 million General Fund for CAL FIRE to contract for additional helicopters and seasonal helicopter crews during peak fire season.
- Fish and Wildlife—A decrease of $4.2 million General Fund to reflect improved conditions in the north, reducing the necessity for fish rescues and water infrastructure and conveyance improvements.
- Save Our Water Campaign—A reduction of $3 million General Fund from the Save Our Water Campaign to reflect the reduced need for a statewide campaign this year.

Manage and Prepare for Future Droughts

California's hydrology is volatile and complex. Flooding and drought conditions can occur at the same time. Temperatures in the southern coastal areas set records for the third year in a row. This year, the Colorado River, which provides roughly one-third of the water supply for Southern California, is in its 16th year of drought. Although the state has managed well in many respects, drought conditions have exposed weaknesses of the state's water system and the laws that govern it. For example, thousands of water rights in California require no permit or license. Consequently, the State lacks basic information needed to accurately apply the water right priority system, especially during dry periods. The Administration is interested in collecting more accurate information to protect water rights and to improve water accounting.

Both climate change and future population growth will place increasing pressure on the state's water supplies. The current drought may persist into 2017 and beyond, and droughts will continue to be regular events in California. Warmer winter temperatures driven by climate change will reduce water supply held in mountain snowpack and result in drier soil conditions. California needs to adopt permanent changes that help the state manage the current drought and prepare for future droughts.

Conservation as a Way of Life

California must use water more efficiently. Californians have responded to the drought by conserving water at significant levels, reducing water use in communities by 23.9 percent between June 2015 and March 2016, and saving enough water during this period to provide 6.5 million Californians with water for one year.

On May 9, 2016, the Governor issued an executive order directing the State Water Resources Control Board to adjust its emergency water restrictions to account for this winter's snow and rain. While drought conditions have improved in many parts of the state, California needs to improve water conservation continuously to become more resilient in future droughts.

Efficient water use requires a multifaceted approach by state and local government. The state must provide a unifying framework with targets for efficient water use, prohibitions on wasting water, standards for minimizing system leaks, and criteria for local water agencies to measure their success. Fundamentally, though, local and regional water suppliers plan, manage, and deliver water. To endure future droughts, local suppliers must take the lead to develop substantive, reliable plans based on their local supplies and circumstances.

Significant Adjustment:

- Drought Preparedness and Resiliency for Urban Water Agencies—An increase of $4.5 million General Fund for a coordinated effort by the Department of Water Resources and the Water Board to review and update local water shortage contingency plans, develop recommendations for new water use efficiency targets, and establish a permanent urban water use efficiency data tracking system, consistent with the directives of the most recent executive order.

Enabling Successful Implementation of Sustainable Groundwater Management

Two years ago, the state adopted historic legislation to manage groundwater sustainably. The Sustainable Groundwater Management Act (Groundwater Act) recognized that groundwater management is most successful when done locally. In the high and medium-priority basins, local government sustainability agencies need to be formed by June 30, 2017. Effective governance structures are urgently needed to implement the Groundwater Act.

Significant Adjustments:

- Groundwater Sustainability Agency Facilitation—An increase of $1 million General Fund for the Department of Water Resources to support local public agencies with facilitation services as they implement the Groundwater Act. Successful implementation depends on how well local public agencies coordinate and develop governance structures to meet the new requirements. In an ongoing effort by the Department of Water Resources and the Water Board, these funds will support efficient formation of groundwater sustainability agencies by water districts, counties, cities, and other local groups.
- Statewide Agricultural Land Use Data—An increase of $1 million General Fund for the Department of Water Resources to support the use of remote sensing technology to establish statewide agricultural land use data. Groundwater agencies must develop water budgets to eventually balance water supply and use within basins. To create water budgets, agencies must have estimates of agricultural water demand, and agricultural land use data is more efficiently captured on a statewide scale than by hundreds of separate local agencies.

This page intentionally blank to facilitate double-sided printing.

Environmental Protection

The California Environmental Protection Agency (Cal-EPA) works to restore, protect, and enhance environmental quality. The Agency coordinates state environmental regulatory programs and promotes fair and consistent enforcement of environmental law.

The May Revision includes total funding of $4.3 billion ($87.8 million General Fund) for all programs included in the Agency.

Reducing Lead Exposure

Public health experts increasingly recognize that lead poisoning can occur at lower levels of exposure than previously understood. Children under age six are at the greatest risk—even low levels of exposure can cause irreparable damage to a child's central nervous system and result in other developmental and behavioral problems. Children of low-income families are disproportionately exposed to lead poisoning.

Created in 1991, the Department of Public Health's Childhood Lead Poisoning Prevention Program receives and analyzes children's blood lead tests, provides public health nurse services related to lead exposure, works with health care providers to assure appropriate follow-up and medical services, and performs environmental investigations to assure remediation.

The Governor's Budget includes $8.2 million Childhood Lead Poisoning Prevention Fund for the Department of Public Health to extend services to children who have been exposed to lead, consistent with the guidance for treatment from the federal Centers for Disease Control and Prevention, and to upgrade an information technology system to handle these additional cases. Specifically, the proposal aligns the blood lead levels triggering treatment with the most recent federal recommendations for monitoring, education, and basic services to children.

Additionally, the Governor recently signed legislation, Chapters 9 and 10, Statutes of 2016 (SB 93 and AB 118) which provide a $176.6 million General Fund loan to expedite the cleanup of residential properties contaminated with lead around the former Exide Technologies facility in Vernon. The first $46.9 million of this funding will be spent by the end of 2016-17.

The May Revision builds on these proposals by supporting additional lead-related programs administered by the Department of Public Health, State Water Resources Control Board, and Department of Toxic Substances Control.

Significant Adjustments:

- Childhood Lead Mapping—An increase of $180,000 Childhood Lead Poisoning Prevention Fund for the Department of Public Health to upgrade the information technology system to include geographic information system functionality, thereby providing more timely and accurate data on sources of lead exposure and contamination throughout the state. The geographic information system functionality also helps the state respond to instances of lead contamination.
- Improved Monitoring and Reporting of Drinking Water—An increase of $480,000 Safe Drinking Water Account and two positions for the State Water Resources Control Board to: (1) prepare guidance documents and engage in outreach to schools to assist local efforts for water quality testing, and (2) support public water systems in improving compliance with federal reporting requirements.
- Lead Acid Batteries—An increase of $255,000 Toxic Substances Control Account and two positions for the Department of Toxic Substances Control to evaluate listing lead acid batteries as "priority products" subject to the Department's Safer Consumer Products regulations. As part of the Hazardous Waste Reduction Initiative, the Department will conduct research, engage with stakeholders, evaluate options, and implement recommended actions to better protect the people and environment of California from adverse impacts related to the manufacture, use, recycling, and disposal of lead acid batteries.

Enhancing Environmental Justice

In 2013, Cal-EPA created the Environmental Justice Compliance and Enforcement Working Group (Working Group) to more fully integrate environmental justice into enforcement of environmental laws across state departments. Through the Working Group, Cal-EPA and its boards and departments led pilot enforcement and compliance initiatives in two of the most environmentally burdened areas of the state, one in Fresno and another in the Boyle Heights and Pacoima neighborhoods in Los Angeles. The Working Group conducted community outreach, engaged local agency enforcement partners, conducted compliance assistance and inspections, and took actions to return regulated entities to compliance when violations were observed. In addition to correcting violations discovered through inspections, the pilot programs created conditions that will lead to greater environmental compliance in the future and improved working relationships between the community and local, state, and federal regulatory agencies. These pilot projects demonstrate a need for permanent resources to continue and enhance enforcement and compliance activities in disadvantaged communities statewide.

Additionally, the May Revision includes a proposal of $2.3 million Oil, Gas, and Geothermal Administrative Fund and four positions for the Air Resources Board to support neighborhood air quality monitoring near oil and gas facilities and enhance the Board's emergency response capabilities.

The May Revision builds on these efforts by supporting additional enforcement and monitoring in disadvantaged communities.

Significant Adjustments:

- Expanded Enforcement in Environmental Justice Communities—An increase of $904,000 various special funds and six positions to make the Working Group pilot permanent. The Working Group will continue reducing adverse environmental impacts in the most vulnerable communities and expand its work to other disadvantaged communities. This effort will allow for more frequent and efficient enforcement and compliance initiatives in more areas identified as the most disadvantaged in the state.
- Pesticide Air Monitoring—An increase of $2.3 million other funds and five positions for the Department of Pesticide Regulation and the Air Resources Board to strengthen California's existing pesticide air monitoring network program. This proposal expands the current network of year-round pesticide air monitoring

stations, enhances pesticide laboratory analysis capabilities, and resumes seasonal ambient pesticide monitoring to better evaluate the impact of pesticides on children's health and in disadvantaged communities.

Natural Resources

The Natural Resources Agency consists of 26 departments, boards, commissions, and conservancies responsible for administering programs to conserve, protect, restore, and enhance the natural, historical, and cultural resources of California.

The May Revision includes total funding of $9.5 billion ($2.8 billion General Fund) for all programs included in the Agency.

Department of Parks and Recreation

The Department of Parks and Recreation protects and preserves significant cultural and natural resources while providing recreational opportunities, including horseback riding, boating, mountain biking, hiking, camping, mountain climbing, and off-highway vehicle activities. There are 280 state parks organized into 22 field districts.

In 2015, the Administration established a Transformation Team to help strengthen state parks through a series of initiatives supporting strategic goals, such as improving visitors' experiences and making the system more relevant to a broader and more diverse population. One initiative is to update the Department's organizational structure. The Transformation Team, comprised of experienced Department staff and outside experts, continues to work with internal and external stakeholders as it develops a new model for the Department. Through this process, the Transformation Team, together with the Department, will update the organizational structure to eliminate duplicative services, realign divisions and programs to better support field operations, consolidate some field districts, flatten field management structures, and establish career paths to leadership for a broad range of professional backgrounds.

Significant Adjustment:

- California History Interpretation Pilot Program—An increase of $348,000 State Parks Protection Fund to fund a two-year pilot project to develop and implement an innovative approach to improving public interpretation. This pilot program builds upon a new collaborative partnership with the University of California at California Citrus State Historic Park and El Presidio de Santa Barbara State Historic Park. A successful pilot program will establish a new model for interpretation of California's rich history and culture through state parks. This program, along with the community liaison project included in the Governor's Budget, creates culturally relevant interpretive and environmental programs. The Department will also seek expansion of this project through partnerships and philanthropic support.

Statewide Issues and Various Departments

This Chapter describes items in the Budget that are statewide issues or related to various departments.

Employee Compensation and Collective Bargaining

The Administration is currently in active contract negotiations with 17 of the state's 21 bargaining units. Recently, the Administration negotiated successor contract agreements with Correctional Peace Officers and Professional Scientists, whose unit contracts with the state expired in early July 2015. Through the collective bargaining process, the Administration remains focused on addressing the state's $74 billion unfunded liability for retiree health benefits. The strategy for addressing the liability includes equal cost-sharing between the employee and employer to pre-fund retiree health benefits, extending the period to qualify for retiree health benefits, and reducing the employer subsidy for retiree health benefits. Agreements reached with the Correctional Peace Officers, Engineers, and Scientists have included these retiree health provisions.

The May Revision reflects a $362 million ($314 million General Fund) increase in employee compensation and retiree health care costs relative to the Governor's Budget. These additional costs are driven primarily by increases to salaries and benefits recently negotiated with Correctional Peace Officers and Professional Scientists and pay increases related to minimum wage changes in Chapter 4, Statutes of 2016 (SB 3). The May Revision also includes retention incentives for Department of Developmental Services employees working in facilities that will be closing in the coming years.

The May Revision also includes a proposal to more closely align the benefit structure of state-level employees in the Judicial Branch with other civil service employees. As part of this proposal, these employees, excluding justices, will receive a 7.5-percent General Salary Increase over two years, contribute more to their pensions, participate in the Administration's strategies to address the retiree health care unfunded liability, and receive an employer health benefit contribution that is similar to most civil service employees.

Recognizing the substantial and likely cost pressure of negotiating successor contract agreements with remaining units, the May Revision sets aside $500 million ($200 million General Fund) to offset potential employee compensation and benefit cost increases subject to good-faith bargaining under the Ralph C. Dills Act.

Additionally, as part of Chapter 2, Statutes of 2016 (AB 133), the Administration made a one-time allocation of $240 million to pay down the state's unfunded liability for retiree health care. This amount will be apportioned to the trust fund accounts of bargaining units that reach a memorandum of understanding with the Administration by November 1, 2016 and where such agreement includes prefunding for retiree health care.

State Retirement Contributions

The May Revision reflects the following adjustments for state retirement costs:

- State contributions to the California Public Employees' Retirement System (CalPERS) for pension costs have decreased by $89.8 million ($43 million General Fund) relative to the Governor's Budget. The reduction reflects the impact of employees entering the system under the reduced benefit formula pursuant to the Public Employees' Pension Reform Act of 2013 and greater-than-expected contributions to the system.
- State contributions to the California State Teachers' Retirement System (CalSTRS) increased by $4.6 million General Fund due to revised compensation for K-12 and community college teachers.

Figure SWE-01 below provides a historical overview of contributions to CalPERS, CalSTRS, the Judges' Retirement System (JRS), the Judges' Retirement System II (JRS II), and the Legislators' Retirement System (LRS) for pension and health care benefits.

Figure SWE-01
State Retirement and Health Care Contributions[1]
(Dollars in Millions)

	CalPERS[2]	CSU CalPERS	CalSTRS	JRS	JRS II	LRS	Active Health & Dental[3]	Retiree Health & Dental	CSU Retiree Health
2007-08	$ 2,999		$ 1,623 [4]	$ 162	$ 37		$ 2,020	$ 1,114	
2008-09	3,063		1,133	189	40		2,146	1,183	
2009-10	2,861		1,191	184	32		2,120	1,182	
2010-11	3,230		1,200	166	54		2,277	1,387	
2011-12	3,174		1,259	195	58		2,439	1,505	
2012-13	2,948 [5]	$ 449 [5]	1,303	160	51		2,567	1,365 [5]	$ 222 [5]
2013-14	3,269	474	1,360	188	52	$ 1	2,697	1,383	225
2014-15	4,042	543	1,486	179	63	1	2,797	1,462	256
2015-16[6]	4,338	585	1,935	190	67	1	2,938	1,585	264
2016-17[6]	4,754	621	2,473	202	68	1	3,131	1,744	291

[1] The chart does not include contributions for University of California pension or retiree health care costs.

[2] In addition to the Executive Branch, this includes Judicial and Legislative Branch employees. Contributions for judges and elected officials are included in JRS, JRS II, and LRS.

[3] These amounts include health, dental, and vision contributions for employees within state civil service, the Judicial and Legislative Branches, and CSU.

[4] Includes repayment of $500 million from 2003-04 Supplemental Benefit Maintenance Account withholding/lawsuit loss (interest payments not included).

[5] Beginning in 2012-13, CSU pension and health care costs are displayed separately.

[6] Estimated as of the 2016-17 May Revision. 2016-17 General Fund costs are estimated to be $2,506 million for CalPERS, $621 million for CSU CalPERS, $1,739 million for Retiree Health & Dental, and $1,554 million for Active Health and Dental. The remaining totals are all General Fund.

Minimum Wage Increase

In April 2016, the Governor signed legislation making California the first state in the nation to commit to raising the minimum wage to $15 per hour statewide. The legislation increases the minimum wage to $10.50 per hour beginning January 1, 2017, for businesses with 26 or more employees. The minimum wage will incrementally increase to $15 per hour for all businesses by 2023. This historic action provides additional time for small businesses with 25 or fewer employees to phase in the increases and flexibility to pause the scheduled increases if negative economic or budgetary conditions emerge.

The May Revision includes $39.4 million General Fund to fund state costs associated with the first scheduled increase. This includes increased state employee wages, increased payments to In-Home Supportive Services providers and community-based service providers for residents with developmental disabilities, increases in Medi-Cal costs, and increases for other costs associated with the new minimum wage allocated through a new statewide Budget Act control section. This also reflects modest savings associated with lower enrollment in Medi-Cal and CalWORKs due to the minimum wage increase's effects on families' incomes.

Judicial Branch

The Judicial Branch consists of the Supreme Court, courts of appeal, trial courts, and the Judicial Council. The trial courts are funded with a combination of funding from the General Fund, county maintenance-of-effort requirements, fines, fees, and other charges. Other levels of the Judicial Branch receive most of their funding from the General Fund.

Significant Adjustments:

- Trial Court Civil Case Management System (V3) Replacement—The May Revision includes an additional $12.4 million General Fund to replace V3 Court Case Management Systems in the Superior Courts in Orange, Sacramento, San Diego, and Ventura counties. This funding will enable these trial courts to establish a digital court foundation by implementing a modern and supportable case management system needed to efficiently deliver services to the public.
- Trial Court Employee Costs—The May Revision includes an additional $531,000 to reflect health benefit and retirement costs for trial court employees.

Office of Emergency Services

The principal objective of the Office of Emergency Services (OES) is to protect lives and property, build capabilities, and support communities for a resilient California. The OES collaborates with local governments in preparing for and responding to hazards and threats. During an emergency, the OES functions as the Governor's immediate staff to provide guidance and coordinate the state's responsibilities while responding to disasters such as fires, floods, earthquakes, and terrorism. To support the OES, the May Revision includes total funding of approximately $1.52 billion ($208 million General Fund).

Significant Adjustments:

- California Disaster Assistance Act — An increase of $30 million General Fund to support local jurisdictions using the California Disaster Assistance Act program. The program supports recovery from all disasters, such as tree mortality, wildfires, earthquakes, floods, and drought.
- California Earthquake Early Warning — An increase of $10 million General Fund to support the implementation of the California Earthquake Early Warning System and Program for a comprehensive and reliable earthquake early warning system statewide. The proposed funding will be used to perform research on necessary technology and other technical aspects which will integrate public and private infrastructure, provide public education, and conduct training.

State Appropriations Limit Calculation

2016-17 State Appropriations Limit (SAL) Calculation — Pursuant to Article XIIIB of the California Constitution, the 2016-17 SAL is estimated to be $99.787 billion. This amount is used for various calculations related to state budgeting. The revised limit is the result of applying the growth factor of 5.96 percent. The revised 2016-17 limit is $950 million above the $98.837 billion estimated in January. This increase is due to changes in the following factors:

- Per Capita Personal Income
  - January Percentage Growth: 4.36%
  - May Revision Percentage Growth: 5.37%
- State Civilian Population
  - January Percentage Growth: 0.87%
  - May Revision Percentage Growth: 0.90%
- K-14 Average Daily Attendance
  - January Percentage Growth: 0.16%
  - May Revision Percentage Growth: 0.10%

This page intentionally blank to facilitate double-sided printing.

Economic Outlook

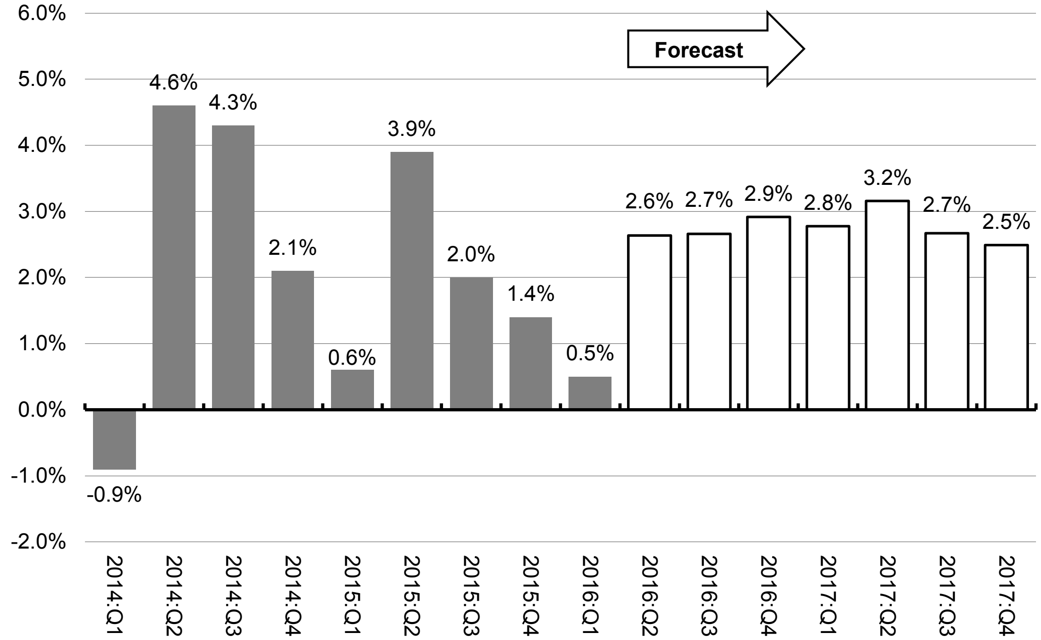
Continued growth is expected over the next few years for California, as rising wages and lower gasoline prices allow consumers to spend more. However, there are some signs that the pace of growth is slowing as the economy returns to pre-recession levels of unemployment.

The Nation — Uneven Growth

The unemployment rate in the U.S. has remained around 5 percent since the fourth quarter of 2015. Steady job growth has encouraged workers to rejoin the labor force, with 63 percent of people ages 16 and above either employed or looking for work. While a decreasing or static labor force participation rate is expected with an aging population, the participation rate has been rising, indicating some optimism among workers. Average wages are rising as well, supporting stronger consumer spending on both goods and services — a trend that is expected to continue for the next few years.

With weak business investment and lower exports in the first quarter, real gross domestic product (GDP) growth is expected to be around 2 percent in 2016, down slightly from the growth rates of 2.4 percent in 2014 and 2015. The forecast assumes real GDP growth will rise to 2.8 percent in 2017, as business investment grows and exports strengthen along with the global economy. (See Figure ECO-01 for details.) Inflation remains below 2 percent, and the Federal Reserve is expected to raise interest rates even more gradually than assumed in the Governor's Budget.

Figure ECO-01
U.S. Real Gross Domestic Product
Quarter-to-Quarter growth, annualized



Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

California—Job Growth Has Slowed

California's unemployment rate fell to 5.4 percent in March, the closest it has been to the national unemployment rate since early 2007. The number of unemployed workers has decreased significantly from around 2.2 million in 2010 to just over 1 million in early 2016. California's labor force participation rate has remained at around 62 percent. The state added 40,000 jobs a month on average in 2015, but the pace has begun to slow, with about 15,000 jobs per month added on average during the first few months of 2016. New data on farm employment showed that jobs continued to be added through 2015. With a wet winter in early 2016, farm employment is expected to continue to grow.

Personal income grew much faster than expected in 2015, due to both an increase in jobs and higher wages. The forecast incorporates each of the scheduled minimum wage increases. This leads to slightly slower job growth and slightly faster wage growth than assumed in the Governor's Budget.

The level of new housing permit activity continues to be well below pre-recession levels, with only 95,000 permits issued in 2015. The increase in housing continues to lag well behind population growth, worsened by the loss of hundreds of homes destroyed by large fires in 2015. Permits are expected to increase slowly over the next few years.

Overall inflation in California has been higher than in the U.S. as a whole, due to higher housing and energy costs, and this trend is expected to continue. See Figure ECO-02 for highlights of the national and California forecasts.

Risks to Consider

The main risks to the state's economy remain slowing global growth, a stock market correction, and the eventual end of the current expansion.

Emerging market growth, including China, has been slowing and is expected to remain low. There is also some uncertainty about the growth path in the European Union, particularly if Great Britain exits the union. Slower growth in one or both, or a change in U.S. fiscal policy, could dampen U.S. growth.

The stock market remains volatile, and a major, lasting correction would have consequences for the California economy. The S&P 500 index is around where it was at the end of 2015 after some volatility earlier this year. Downward revaluations of some high-profile technology firms may be an indicator of future drops in stock prices.

The current expansion has lasted since mid-2009, but the average length is only around five years. With the longest U.S. expansion having lasted ten years, it would be unprecedented not to have a recession by 2020. While the forecast assumes all scheduled minimum wage increases through 2023 occur, a recession could result in a pause in scheduled increases. A recession typically is preceded by imbalances in the economy that show up as increased inflation. Overall, inflation is still relatively low at around 1 percent in early 2016. Yet, U.S. inflation has begun to rise slowly due to increased wages and rebounding oil prices since dropping below $30 per barrel in January.

Figure ECO-02

Selected Economic Indicators

United States	2011	2012	2013	2014	2015	2016 Projected	2017 Projected
Nominal gross domestic product, $ billions	$ 15,518	$ 16,155	$ 16,663	$ 17,348	$ 17,947	$ 18,591	$ 19,491
Real gross domestic product, percent change	1.6%	2.2%	1.5%	2.4%	2.4%	2.1%	2.8%
Contributions to real GDP growth							
Personal consumption expenditures	1.6%	1.0%	1.2%	1.8%	2.1%	1.8%	2.1%
Gross private domestic investment	0.7%	1.5%	0.7%	0.9%	0.8%	0.1%	1.0%
Net exports	0.0%	0.1%	0.2%	-0.2%	-0.6%	-0.2%	-0.3%
Government purchases of goods and services	-0.7%	-0.4%	-0.6%	-0.1%	0.1%	0.4%	0.1%
Personal income, $ billions	$ 13,255	$ 13,915	$ 14,068	$ 14,694	$ 15,340	$ 15,933	$ 16,707
Corporate profits, percent change	4.0%	10.0%	2.0%	1.7%	-3.1%	1.8%	3.6%
Housing permits, thousands	624	830	991	1,052	1,178	--	--
Housing starts, thousands	612	784	928	1,001	1,107	1,200	1,388
Median sales price of existing homes	$ 166,200	$ 177,200	$ 197,400	$ 208,300	$ 222,400	--	--
Federal funds rate, percent	0.1%	0.1%	0.1%	0.1%	0.1%	0.6%	1.4%
Consumer price index, percent change	3.2%	2.1%	1.5%	1.6%	0.1%	1.0%	2.2%
Unemployment rate, percent	8.9%	8.1%	7.4%	6.2%	5.3%	4.8%	4.7%
Civilian labor force, millions	153.6	155.0	155.4	155.9	157.1	159.6	161.7
Nonfarm employment, millions	131.9	134.2	136.4	138.9	141.8	144.5	146.5
California							
Personal income, $ billions	$ 1,691	$ 1,812	$ 1,850	$ 1,940	$ 2,061	$ 2,174	$ 2,289
California exports, percent change	11.3%	1.5%	3.9%	3.4%	-4.9%	--	--
Housing permits, thousands	47	59	86	86	95	107	126
Housing unit net change, thousands	36	45	59	69	67	--	--
Median sales price of existing homes	$ 286,040	$ 319,310	$ 407,150	$ 446,890	$ 474,420	--	--
Consumer price index, percent change	2.6%	2.2%	1.5%	1.8%	1.5%	2.2%	2.8%
Unemployment rate, percent	11.6%	10.3%	8.8%	7.5%	6.3%	5.3%	5.2%
Civilian labor force, millions	18.4	18.5	18.7	18.8	19.0	19.1	19.3
Nonfarm employment, millions	14.4	14.8	15.2	15.6	16.1	16.4	16.7
Percent of total nonfarm employment							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	3.9%	4.0%	4.2%	4.3%	4.6%	4.9%	5.3%
Manufacturing	8.7%	8.5%	8.3%	8.2%	8.0%	8.0%	7.9%
High technology	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%	2.1%
Trade, transportation, and utilities	18.6%	18.5%	18.4%	18.4%	18.3%	18.3%	18.2%
Information	3.0%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%
Financial activities	5.3%	5.2%	5.2%	5.0%	5.0%	4.9%	4.9%
Professional and business services	14.8%	15.2%	15.4%	15.6%	15.6%	15.4%	15.3%
High technology	2.3%	2.4%	2.4%	2.5%	2.6%	2.6%	2.6%
Educational and health services	14.9%	15.1%	15.2%	15.2%	15.3%	15.2%	15.2%
Leisure and hospitality	10.6%	10.8%	11.1%	11.3%	11.4%	11.6%	11.6%
Other services	3.4%	3.4%	3.4%	3.4%	3.4%	3.3%	3.3%
Government	16.7%	16.1%	15.7%	15.5%	15.3%	15.2%	15.2%

Forecast based on data available as of April 2016.
Percent changes calculated from unrounded data.

Revenue Estimates

Overall, the May Revision revenue forecast for 2014-15 through 2016-17 has decreased by $1.9 billion. There are three factors that largely explain this reduction:

- A combined reduction of $2.3 billion in 2015-16 and 2016-17 due to poor personal income tax receipts and weaker sales tax revenues through the end of April.
- A combined revenue reduction of $300 million for the insurance tax and corporation tax related to changes in the financing structure for managed care organizations.
- An offsetting increase of $400 million in cash receipts from corporations that accrued to 2014-15.

After accounting for transfers, which includes transfers to the Rainy Day Fund and loan repayments, General Fund revenues under the May Revision forecast are lower than the Governor's Budget by $537 million in 2015-16 and $553 million in 2016-17.

Figure REV-01 compares the revenue forecasts by source in the Governor's Budget and the May Revision. Total May Revision revenue, including transfers, is projected to be $117 billion in 2015-16 and $120.1 billion in 2016-17.

Figure REV-01
2016-17 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 14-15: Final				
Personal Income Tax	$76,079	$76,169	$90	0.1%
Sales & Use Tax	23,709	23,682	-27	-0.1%
Corporation Tax	9,007	9,417	410	4.6%
Insurance Tax	2,445	2,445	0	0.0%
Alcoholic Beverage	357	357	0	0.0%
Cigarette	86	86	0	0.0%
Pooled Money Interest	21	21	0	0.0%
Other Revenues	1,594	1,592	-2	-0.1%
Subtotal	$113,298	$113,769	$471	
Transfers [1]	-1,980	-1,980	0	0.0%
Total	**$111,318**	**$111,789**	**$471**	0.4%
Fiscal 15-16				
Personal Income Tax	$81,354	$79,962	-$1,392	-1.7%
Sales & Use Tax	25,246	25,028	-218	-0.9%
Corporation Tax	10,304	10,309	5	0.0%
Insurance Tax	2,493	2,486	-7	-0.3%
Alcoholic Beverage	366	370	4	1.2%
Cigarette	84	87	3	3.6%
Pooled Money Interest	36	38	3	7.7%
Other Revenues	1,584	1,695	111	7.0%
Subtotal	$121,466	$119,975	-$1,491	
Transfers [1]	-3,929	-2,975	954	-24.3%
Total	**$117,537**	**$117,000**	**-$537**	-0.5%
Fiscal 16-17				
Personal Income Tax	$83,841	$83,393	-$448	-0.5%
Sales & Use Tax	25,942	25,727	-215	-0.8%
Corporation Tax	10,956	10,993	37	0.3%
Insurance Tax	2,549	2,345	-204	-8.0%
Alcoholic Beverage	373	376	3	0.9%
Cigarette	81	85	4	4.9%
Pooled Money Interest	89	63	-26	-29.3%
Other Revenues	1,247	1,176	-71	-5.7%
Subtotal	$125,078	$124,160	-$918	
Transfers [1]	-4,445	-4,080	365	-8.2%
Total	**$120,633**	**$120,080**	**-$553**	-0.5%
Three-Year Total			**-$619**	

Note: Numbers may not add due to rounding.
[1] Includes transfers to the Budget Stabilization Account for each year.

Long-Term Forecast

The May Revision economic forecast reflects continued growth over the next four years. The projected average growth rate in U.S. real gross domestic product over the next four years is 2.5 percent. While the forecast does not project a recession, the current expansion has already exceeded the average post-World War II expansion by over two years.

Figure REV-02 shows the forecast for the largest three General Fund revenues from 2014-15 through 2019-20. Total General Fund revenue from these sources is expected to grow from $109.3 billion in 2014-15 to $129.5 billion in 2019-20. The average year-over-year growth rate during this period is 4.8 percent.

Figure REV-02
Long-Term Revenue Forecast - Three Largest Sources
(General Fund Revenue - Dollars in Billions)

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Average Year-Over-Year Growth
Personal Income Tax	$76.2	$80.0	$83.4	$86.7	$85.9	$88.1	4.7%
Sales and Use Tax	$23.7	$25.0	$25.7	$26.2	$27.4	$28.7	4.0%
Corporation Tax	$9.4	$10.3	$11.0	$11.5	$12.1	$12.8	6.1%
Total	**$109.3**	**$115.3**	**$120.1**	**$124.5**	**$125.4**	**$129.5**	4.8%
Growth	11.3%	5.5%	4.2%	3.6%	0.7%	3.3%	

Note: Numbers may not add due to rounding.

Earned Income Tax Credit

The 2015 Budget enacted the state's first-ever Earned Income Tax Credit to help the poorest working families in California. Based on tax returns filed through April, over 350,000 households have claimed the credit, including 57,000 new claimants who had not previously filed a California tax return. Many of these first-time filers are expected to have claimed the federal credit for the first time as well. While over 15 percent of the claimants are first-time filers, preliminary data suggest that more than 68,000 eligible households did not claim the California credit. To reach more Californians eligible for both the state and federal Earned Income Tax Credit, the May Revision includes $2 million for the Franchise Tax Board (FTB) to support additional outreach and marketing. Eligible claimants for the 2015 credit remain eligible to claim the credit through October 2016.

Personal Income Tax

The personal income tax forecast is higher by $90 million in 2014-15 and lower by $1.4 billion in 2015-16 and $448 million in 2016-17. Over the three-year period, the personal income tax forecast reflects a total decrease of $1.7 billion.

The forecast reflects lower cash receipts of $1.1 billion through the end of April. In addition, based on more complete data provided by FTB, capital gains realizations reported on 2014 tax returns were $115 billion—$15 billion below forecast. Projected capital gains realizations for 2015 and 2016 were also reduced by $15 billion and $10 billion, respectively. These changes to capital gains reduce tax revenues from this income source. Consistent with the Governor's Budget assumptions, capital gains are forecast to return to a normal level of 4.5 percent of personal income by 2018, which equates to $107 billion in capital gains realizations.

Forecasting revenue associated with capital gains is difficult since realizations are heavily dependent upon stock market performance and when taxpayers choose to buy or sell stock. This forecast assumes the S&P 500 at 2,070 for the second quarter of 2016 and growth of around 2 percent per year for the next several years. Projected S&P 500 levels are lower by about 1 percent compared to the Governor's Budget.

While revenue from high-income taxpayers continues to grow, FTB data on tax returns showed that the 2014 increase in income concentration was modestly below forecast. This change in income concentration reduces effective tax rates and dampens personal income tax growth compared to the prior forecast. The decreases in capital gains and changes in income concentration were offset by higher levels of business income and a stronger wage growth forecast, which leads to personal income tax revenue gains beginning in 2017-18, when capital gains are similar to the Governor's Budget levels.

The personal income tax forecast includes Proposition 30 revenues, which are estimated at $6.8 billion in 2015-16 and $6.9 billion in 2016-17, which is lower than the Governor's Budget by $830 million and $789 million, respectively. Proposition 30 revenues are lower due to the factors discussed above.

The highest-income Californians pay a large share of the state's personal income tax. For the 2014 tax year, the top 1 percent of income earners paid over 48 percent of personal income taxes. This percentage has been greater than 40 percent for ten of the last twelve years. Consequently, changes in the income of a relatively small group of taxpayers have a significant impact on state revenues.

Sales and Use Tax

The sales tax forecast reflects a decrease of $27 million in 2014-15, $218 million in 2015-16, and $215 million in 2016-17. This includes Proposition 30 revenues totaling

$1.5 billion in 2015-16 and $800 million in 2016-17. The sales tax portion of Proposition 30 sunsets at the end of 2016, halfway through 2016-17.

While wages have been revised higher, cash receipts have been below forecast. Weak business spending, lower housing permits, and inflation in housing and medical costs are likely contributing to lower sales tax revenues. Although growth rates have been modestly revised downward, the forecast assumes that taxable sales will grow at 5 percent in 2015-16 and 5.8 percent in 2016-17, which are above-average growth rates.

Corporation Tax

The corporation tax forecast reflects an increase of $410 million in 2014-15, $5 million in 2015-16, and $37 million in 2016-17. Cash receipts this year are above forecast primarily due to unusually large payments related to prior year returns. These payments accrue to 2014-15 and increase revenues in that fiscal year. Changes to the financing structure for managed care organizations reduce revenue by $90 million in 2016-17.

Insurance Tax

The insurance tax forecast reflects a decrease of $7 million in 2015-16 and $204 million in 2016-17. Changes to the financing structure for managed care organizations reduce insurance revenue by $210 million in 2016-17.

Loan Repayments to Special Funds

The Governor's Budget reflected repayment of loans based on the operational needs of various special fund programs and Proposition 2's dedicated funding stream for reducing debts and liabilities. The May Revision reflects a total of $647 million in loan repayments to special funds in 2016-17, which is a decrease of $244 million compared to the Governor's Budget. An updated evaluation has been made to ensure programs' operational needs will be met at this reduced level. Total funding available for Proposition 2 debt payments decreased due to lower forecasted revenues and capital gains since the Governor's Budget.

Property Tax

The May Revision estimates statewide property tax revenues will increase 5.9 percent in 2015-16 and 6.2 percent in 2016-17, which is slightly higher than the respective 5.6-percent growth rates estimated in the Governor's Budget. Roughly 42 percent ($29.2 billion) will go to K-14 schools in 2016-17. While this amount includes $1.2 billion that schools are expected to receive pursuant to the dissolution of the redevelopment agencies, it excludes the $7.3 billion shifted to cities and counties to replace Vehicle License Fee (VLF) revenue losses stemming from the reduced VLF rate of 0.65 percent.

Executive Office

Michael Cohen
Director of Finance
(916) 445-4141

Amy Costa
Chief Deputy Director, Budget
(916) 445-9862

Eraina Ortega
Chief Deputy Director, Policy
(916) 445-8582

Todd Jerue
Chief Operating Officer
(916) 445-4923

Kari Krogseng
Chief Counsel
(916) 322-0971

H.D. Palmer
Deputy Director, External Affairs
(916) 323-0648

Jacqueline Wong-Hernandez
Legislative Director
(916) 445-8610

Diane Cummins
Special Advisor to the Governor,
State and Local Realignment
(916) 445-4141

Budget Program Areas

Budget Planning and Preparation, Cash Management, Statewide Budget Issues, and Statewide Accounting Policies and Training	**Veronica Chung-Ng,** *PBM**	(916) 445-5332
Corrections and Rehabilitation, Judicial, Justice, General Government, Business and Consumer Services	**Chris Ryan,** *PBM*	(916) 445-8913
Education	**Jeff Bell,** *PBM*	(916) 445-0328
Employee Relations, State Pension Systems, Local Government, Housing, Local Mandates, Information Technology Consulting Unit	**Justyn Howard,** *PBM*	(916) 445-3274
Health and Human Services	**Vacant,** *PBM*	(916) 445-6423
Audits and Evaluations, Departmental Administration	**David Botelho,** *PBM*	(916) 445-1546
Natural Resources, Energy, Environment, Capital Outlay	**Karen Finn,** *PBM*	(916) 324-0043
Revenue Forecasting, Economic Projections, Demographic Data, Transportation, Labor and Workforce Development	**Kristin Shelton,** *PBM*	(916) 322-2263

*Program Budget Manager

This page intentionally blank to facilitate double-sided printing.