
# May Revision

# 2018-19

***Edmund G. Brown Jr. Governor***

*State of California*

# For Nancy McFadden

1959 – 2018


*"What I value most in my journey is the family of friends I've built and the chance I've had to try to do some good in the world and do so alongside people I like and can laugh with, who I respect and admire."*

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# Introduction

As the state's economy has recovered from the Great Recession, the past five budgets have significantly increased spending—through historic growth in education funding, the creation of the state's first earned income tax credit, a minimum wage that will increase to $15 per hour over time, and the expansion of health care coverage to millions of Californians. The state has also paid down its budgetary borrowing and addressed long-standing problems such as restoring fiscal health to its retirement benefit plans and making major improvements to the state's transportation and water systems.

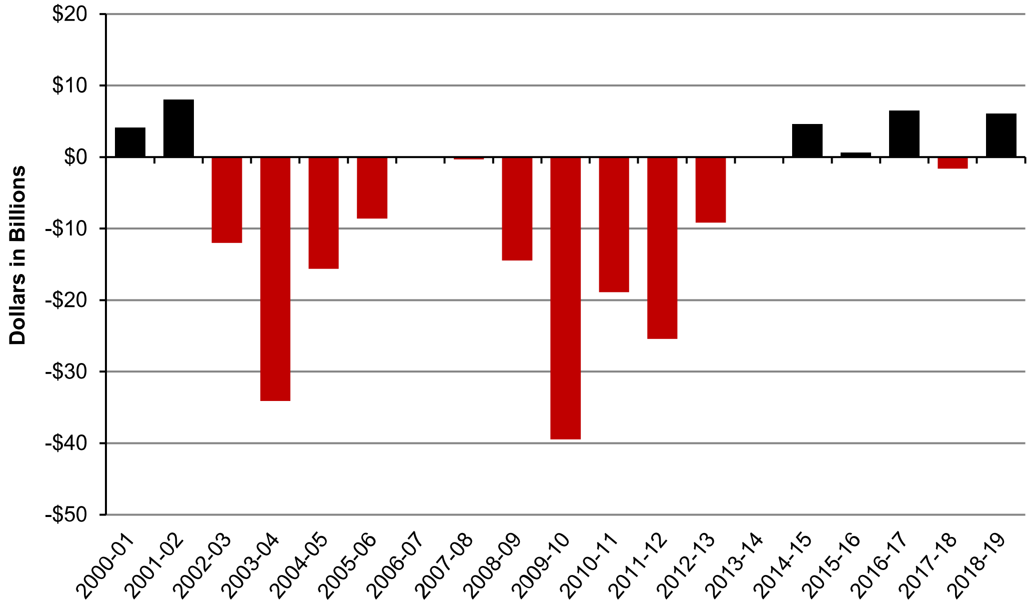
The January Budget was projected to have a healthy one-time surplus and focused the new funds on building up the state's Rainy Day Fund to prepare for the next recession. Since that time, revenues have continued to grow. Capital gains are projected to be at an all-time high and state unemployment is at an all-time low. Despite strong fiscal health in the short term, the risks to the long-term health of the state budget continue to mount—the effects of the 2017 federal tax bill remain uncertain, the nation faces a host of global risks and the volatility of the stock market has returned.

By the end of 2018-19, the U.S. will have matched the longest recovery in modern history. The best way to buffer against uncertainty and protect against future cuts is to continue building the state's reserves and avoid making substantial new ongoing obligations. Consequently, the May Revision proposes to use the surplus on one-time spending to address long-standing infrastructure needs, homelessness and mental health.

## Maintaining a Balanced Budget in Uncertain Times

California's fiscal stability—driven by a balanced budget and a recovering state economy—has been a welcome reprieve from prior budget deficits. As shown in Figure INT-01, the state's short periods of balanced budgets in the 2000s were followed by massive budget shortfalls. The risks of the budget returning to deficits continue to grow:

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 (January).

### Federal Government and Tax Bill

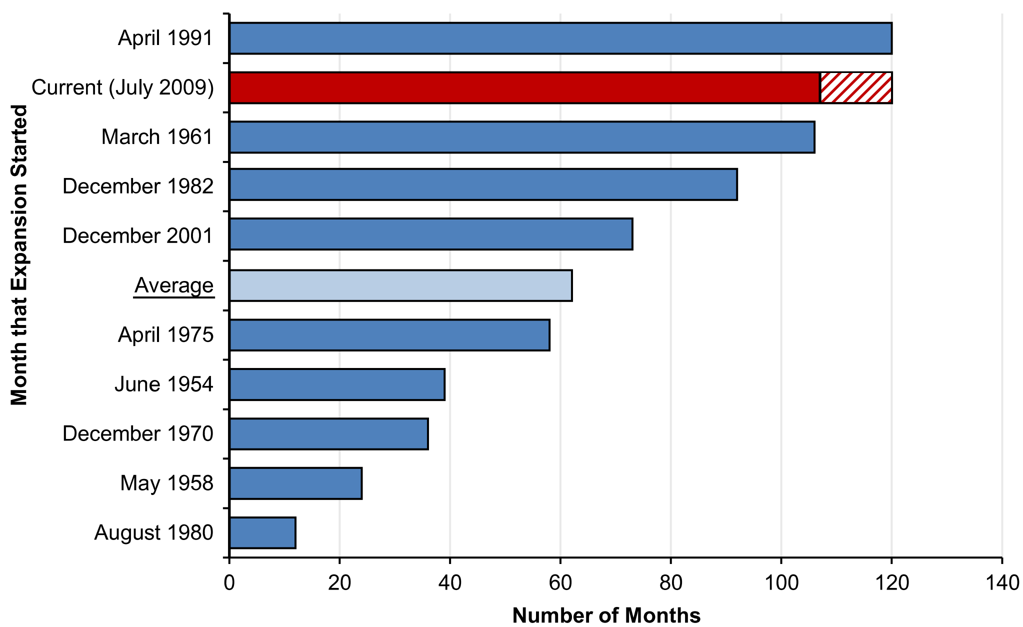
The federal extension of the Children's Health Insurance Program will provide temporary fiscal assistance to the state; yet, California's relationship with the federal government has never been more uncertain. Actions by the federal government could easily overwhelm the state's fiscal capacity. The January Budget's economic and revenue forecasts were finalized prior to the enactment of the federal tax package at the end of December. The May Revision assumes the tax changes will provide a temporary boost to the national economy and provide fiscal gains to many Americans, especially the wealthiest. However, this boost is likely to come at a long-term cost as it will take economic growth from future years and increase income inequality.
By growing the federal deficit to more than $1 trillion each year, the tax package is essentially borrowing from the future to subsidize corporate stock buybacks and executive bonuses. However, the full implications for the state's taxpayers and on federal-state programs will not be known for many years.

The increasing federal deficit caused by the tax bill will also create more pressure for the federal government to cut spending programs through rescissions or some other mechanism. Historically, this has meant shifting a greater burden to states. For instance, the congressional Medicaid proposals that have been debated over the past two years would have shifted tens of billions of dollars in permanent Medi-Cal costs to the state General Fund. Although they have been defeated to date, there is a major risk that they, or similar proposals, could reappear in future years.

## Recession

The May Revision assumes the continued expansion of the economy and a balanced budget through the forecast period. But economic expansions don't last forever.  In the modern era, the average expansion has lasted about five years. By the end of the 2018-19 fiscal year, as shown in Figure INT-02, the U.S. will have matched the longest recovery in modern history.

Figure INT-02
**Current Recovery Is Approaching The Longest Ever**



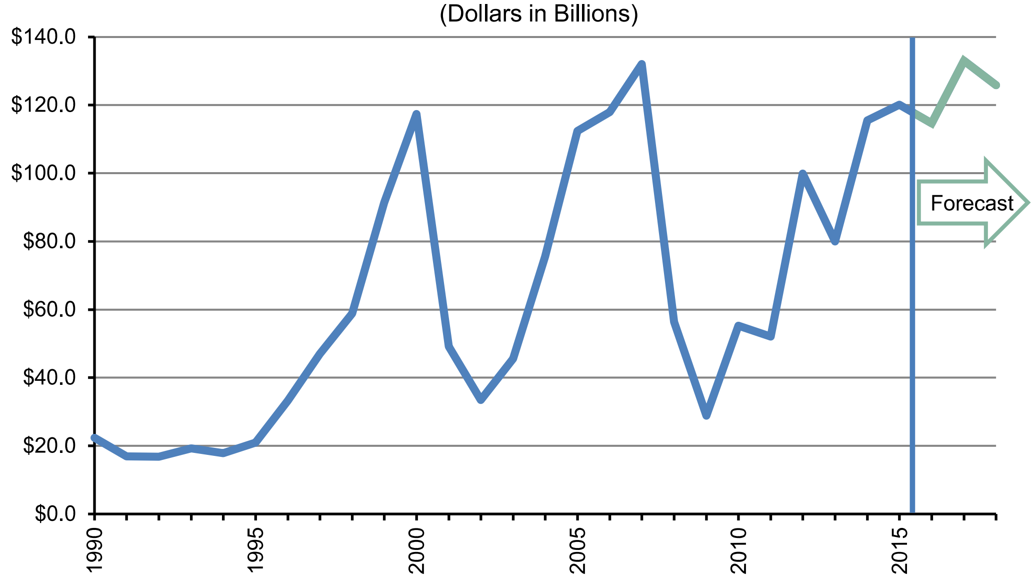

A moderate recession will drop state revenues by over $20 billion annually for several years. Economic forecasts generally do not predict recessions at a particular time. As such, based on the current strength of the economy, the May Revision forecasts growth for the foreseeable future. By continuing to assume economic growth, however, the May Revision forecast is based on factors that history would suggest are extremely unlikely to come to fruition.
For example, in recent history, the state’s unemployment rate has dipped below five percent only twice, in 2000 and 2006. Each time, full employment was short-lived at 7 months

and 11 months respectively. The state's unemployment rate fell to an all-time low of 4.3 percent in February and March, and at that point had been below 5 percent for 11 months. Yet, the May Revision assumes the state will remain below five percent throughout the forecast—an unprecedented length of time.

### Capital Gains

The state's most volatile revenue source—capital gains—is expected to reach an all-time high in 2017 and is forecast to stay at levels never achieved previously through 2022 as shown in Figure INT-03. To achieve these levels, the stock market would need to continue an unprecedented run without a correction.

Figure INT-03
**Volatile Capital Gains on the Rise**
(Dollars in Billions)




## Planning for the Next Recession

The next recession will be upon California soon enough, so a full Rainy Day Fund and a commitment to prudent one-time spending are the best tools available to guide the state through it.

### Filling the Rainy Day Fund

Proposition 2, passed by the voters in 2014, establishes a constitutional goal of reserving 10 percent of tax revenues in a Rainy Day Fund by increasing deposits during high capital gains years. By the end of 2017-18, the state's Rainy Day Fund will have a total balance of $9.4 billion (71 percent of the constitutional target). <u>The state's primary short-term fiscal goal should</u>

continue to be fully filling the Rainy Day Fund by the time the next recession begins. The May Revision maintains the January proposal to provide a supplemental deposit to fully fill the Rainy Day Fund this year.

### Focusing on One-Time Expenditures

The May Revision reflects the receipt of $8 billion in higher revenues through 2018-19 compared to the January Budget. From this amount, the state must pay for substantially higher program costs and ongoing commitments it has made and expanded in recent years, such as Medi-Cal, Cal Grants, child care, In-Home Supportive Services and foster care reform. With the remaining funds, the May Revision makes few new permanent commitments. Instead, in recognition of the growing risks that the state budget faces, it proposes nearly $4 billion in one-time General Fund spending, focused in three areas:

- Infrastructure ($2 billion)—The state has massive liabilities from years of deferred maintenance. The proposal will target these funds to the universities, courts, state facilities and flood control. Investments are also proposed for high-priority capital expenditures.
- Homelessness ($359 million)—In the coming year, new revenues dedicated to addressing the rising cost of housing will begin to flow (from a bond and a fee on real estate transactions). As a bridge to these funds, the May Revision includes a $359 million package of funding to focus on the state's most vulnerable populations and assist local governments in their immediate efforts to address homelessness, including $50 million for individuals with mental illness.
- Mental Health ($312 million)—Although primarily a county responsibility, mental health issues affect the entire state. The May Revision includes funding for enhanced early detection of mental health problems and the education of mental health professionals. The proposals include the repayment of $254 million plus interest in mandate claims to give counties additional resources for youth with mental illness. The May Revision also proposes to place the $2 billion No Place Like Home bond on the November ballot to accelerate the delivery of housing projects to serve the mentally ill.

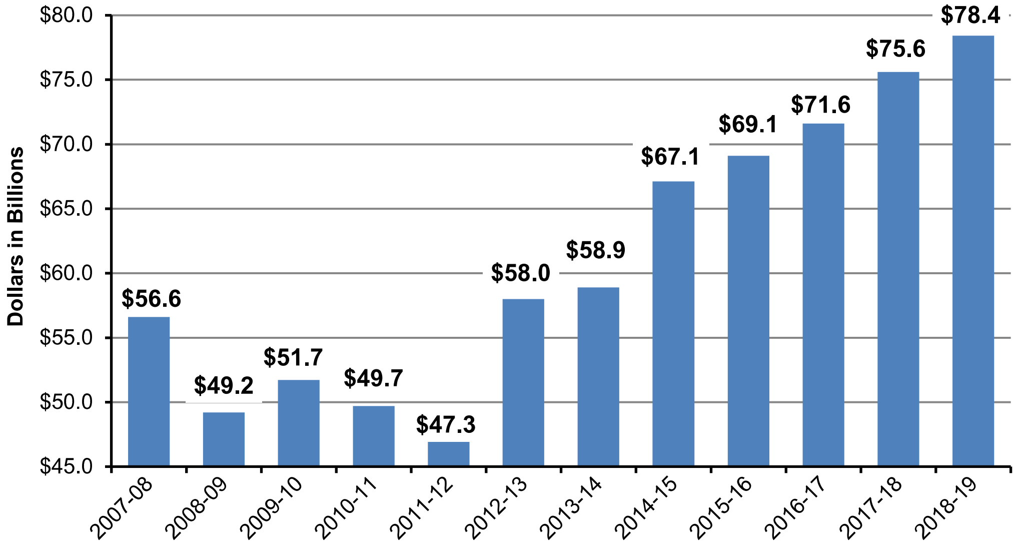
## More Money for Schools

Proposition 30 in 2012 and Proposition 55 in 2016 both increased funding for public education from their reduced levels during the Great Recession.

## K-12 Education

As shown in Figure INT-04, the minimum guarantee of funding for K-14 schools in 2007-08 was $56.6 billion, sinking to $47.3 billion in 2011-12 at the depth of the state budget crisis. From this recent low, funding has grown substantially, and will continue to grow to $78.4 billion in 2018-19—an increase of $31 billion (66 percent) in seven years.

Figure INT-04
**Proposition 98 Funding**
**2007-08 to 2018-19**




For K-12 schools, 2018-19 funding levels will increase by about $4,600 per student over 2011-12 levels. Available funding will allow the state to reach 100 percent implementation of the Local Control Funding Formula, correcting historical inequities in school district funding, as well as permanently increasing the formula's base to assist districts in accommodating rising costs. To enhance certainty for districts regarding funding levels, the May Revision proposes a revised Proposition 98 certification process. This process will result in future certifications occurring more quickly (the last certification was for 2008-09) and increase certainty regarding the payment of outstanding obligations to schools.

## Higher Education

The Administration has continually sought to keep student fees low, promote new technology and innovation and improve graduation rates, all in support of students' success in their educational goals. The May Revision continues the new ongoing resources for higher education proposed in January. With these increases, since their recent lows, the University of California has received $1.2 billion in new funding, the California State University has received $1.6 billion and the community colleges $2.4 billion. Over the same time period, funding for state financial aid, primarily to support low-income students, has increased by $861 million, to a total of $2.4 billion. The May Revision also provides each university system with $100 million in new one-time deferred maintenance funding from the overall allocation described below.

The state's decades-old community college apportionment formula—which favors counting the number of students at a desk at a particular point in time—is not the most effective way for community colleges to reach their goals. Instead, the January Budget proposed a new funding formula that provides supplemental funding to those districts that serve low-income students and provides grants to districts for each student who completes a degree or certificate. As the formula is implemented, no district would receive less funding than currently provided. The May Revision adjusts the new formula to reflect the substantial feedback that colleges and others provided in recent months, providing additional funding to reward successful outcomes for economically disadvantaged students.

Similarly, based on feedback, the May Revision refines the January proposal to create the California Online College by specifying more details on measuring student success, improving governance, developing curriculum, obtaining accreditation and undertaking collective bargaining.

## Counteracting the Effects of Poverty

While California's economic condition has improved since the Great Recession, much of the gains have benefitted the state's wealthiest residents. The recently enacted federal tax package threatens to exacerbate this gap in wealth. Since 2012, the General Fund has committed approximately $21 billion in new annual funding for poverty-focused programs to enhance the state's already extensive safety net for the state's neediest residents.

In addition to full implementation of the K-12 Local Control Funding Formula—which heavily emphasizes services to the state's neediest students—the May Revision expands the Earned Income Tax Credit to workers between the ages of 18 and 25 and those above 64. In addition, the credit's income limits are adjusted to reflect the minimum wage increase to $12 per hour in 2019. The May Revision continues to provide billions of dollars in additional funding to pay for:

- Expanding health care coverage under the federal Affordable Care Act, which provides millions of Californians with insurance.
- Restoring various health benefits to low-income Californians that were eliminated during the recession, including adult dental services.

- Repealing of the maximum family grant rule in CalWORKs, which denied aid to children who were born while their parents were receiving aid.
- Increasing  child care and early education provider rates and the number of children served.

## Combatting Climate Change

California has acted decisively and aggressively to reduce greenhouse gas emissions and address climate change, with a state goal to reduce emissions 40 percent below 1990 levels by 2030. The state's most cost-effective approach to meeting that target is the Cap and Trade Program, which allows the private sector to determine the most appropriate path for reducing emissions through the quarterly auction of pollution credits. In addition to the direct emission reductions required under the program, the state has appropriated $6.5 billion in auction proceeds to further reduce emissions by funding transit and high-speed rail, affordable housing near jobs and services, forest and watershed improvements, healthy soils, recycling and home energy upgrades. The state has prioritized the expenditure of these funds in disadvantaged communities.

The Legislature strengthened Cap and Trade last year by extending the program through 2030. Earlier this year, the Administration proposed $1.25 billion in additional Cap and Trade spending from auction proceeds. The May Revision proposes $50 million in additional auction proceeds (along with other funding) to implement the recently released Forest Carbon Plan that aims to improve the health and resiliency of California's forests against the increasing threats of fire and disease caused by climate change.

## Strengthening Infrastructure

The construction and maintenance of key physical infrastructure is one of the core functions of state government. Infrastructure allows for the movement of goods across the state and the delivery of public services. The deferred maintenance on existing state infrastructure is staggering—estimated to total $20 billion, not including roads and highways. The May Revision includes $2 billion to address the most critical deferred maintenance projects such as levees, high priority state facilities and facilities that are the responsibility of the state's universities and court systems. The 2016-17 Budget also began a major investment in renovating Sacramento's aged and inadequate state office infrastructure, and the May Revision proposes using cash—rather than borrowing—to implement the next components of the plan. Under the state Constitution, once the state's Rainy Day Fund is filled, any additional deposits will be dedicated for additional infrastructure projects.

## Paying Down Debts and Liabilities

As shown in Figure INT-05, the state has $291 billion in long-term costs, debts and liabilities. The vast majority of these liabilities—$287 billion—are related to retirement costs of state and University of California employees. Over the past several years, the Governor and Legislature have taken significant steps to address the long-term costs of its retirement programs.

Figure INT-05

**Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2**

(Dollars in Millions)

| | Outstanding Amount at Start of 2018-19 [2/] | Proposed Use of 2018-19 Pay Down at Governor's Budget | Changes from Governor's Budget | Proposed Use of 2018-19 Pay Down at May Revision |
|---|---|---|---|---|
| **Budgetary Borrowing** | | | | |
| Loans from Special Funds | $1,248 | $205 | $0 | $205 |
| Weight Fees | 1,150 | 325 | 57 | 382 |
| Underfunding of Proposition 98—Settle-Up | 440 | 100 | 0 | 100 |
| Non-Proposition 98 Mandates (Pre 2004) | 18 | 0 | 18 | 18 |
| Pre-Proposition 42 Transportation Loans | 471 | 235 | 0 | 235 |
| **State Retirement Liabilities** | | | | |
| State Retiree Health | 91,008 | 195 | 0 | 195 |
| State Employee Pensions | 58,765 | 475 | 136 | 611 |
| Teachers' Pensions[1/] | 103,468 | 0 | 0 | 0 |
| Judges' Pensions | 3,277 | 0 | 0 | 0 |
| Deferred payments to CalPERS | 682 | 0 | 0 | 0 |
| **University of California Retirement Liabilities** | | | | |
| University of California Employee Pensions | 10,851 | 0 | 0 | 0 |
| University of California Retiree Health | 19,331 | 0 | 0 | 0 |
| **Total** | **$290,709** | **$1,535** | **$211** | **$1,746** |

[1/] The state portion of the unfunded liability for teachers' pensions is $35.3 billion.

[2/] For retiree health and pensions, the amounts reflect latest actuarial report available.

In 2012, the California Public Employees' Pension Reform Act was enacted to save billions of taxpayer dollars by capping pension benefits, increasing the retirement age, stopping abusive practices and requiring employees to pay at least half of their pension costs. In 2014, a funding plan was implemented to restore fiscal solvency to the state's teacher pension system by 2046. In 2015, the state and its employees began to share equally in the prefunding of retiree health benefits to eliminate a then $72 billion unfunded liability. In 2017-18, the state made a $6 billion supplemental payment to CalPERS that is estimated to save a net $4.8 billion in required pension contributions over the next two decades.

Despite these efforts, California's unfunded liabilities continue to rise—by $15 billion since the release of the January Budget alone. If not for the above-noted efforts, these liabilities would be billions of dollars higher. Accounting for all of these actions, and under current assumptions, the state now has plans in place to pay off these liabilities over the next 30 years. The state's multiyear spending forecast accounts for the expected increases in these costs while keeping spending in line with revenues. In other words, the state can continue to manage its retirement expenses while the long-term savings under 2012's pension reform law phase in. California's local governments are facing even greater pressures in accommodating these rising costs.

## Maintaining Fiscal Balance Will Be An Ongoing Challenge

The past six years have been the longest stretch of balanced budgets in recent history. With a volatile revenue structure and limited spending flexibility, the California budget demands constant vigilance to stay in balance. These six years of relative fiscal stability illustrate the benefits of a prudent approach to budgeting—building up a Rainy Day Fund, avoiding overcommitting one-time revenues and making tough decisions when necessary. These years provide a sharp contrast to the decade of budget crises that preceded it—a decade that was defined by using one-time revenues from capital gains for ongoing expenditures while deferring tough decisions through borrowing and gimmicks. The next recession will be upon California soon enough, but a full Rainy Day Fund and a commitment to prudent one-time spending are the best tools available to guide the state through it.

# Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01
**2018-19 May Revision**
**General Fund Budget Summary**
(Dollars in Millions)

| | 2017-18 | 2018-19 |
|---|---|---|
| **Prior Year Balance** | $5,673 | $8,452 |
| Revenues and Transfers | $129,825 | $133,513 |
| **Total Resources Available** | **$135,498** | **$141,965** |
| Non-Proposition 98 Expenditures | $73,665 | $82,537 |
| Proposition 98 Expenditures | $53,381 | $55,025 |
| **Total Expenditures** | **$127,046** | **$137,562** |
| **Fund Balance** | **$8,452** | **$4,403** |
| Reserve for Liquidation of Encumbrances | $1,165 | $1,165 |
| Special Fund for Economic Uncertainties | $7,287 | $3,238 |
| **Budget Stabilization Account/Rainy Day Fund** | **$9,410** | **$13,767** |

Figure SUM-02

**General Fund Expenditures by Agency**

(Dollars in Millions)

| | 2017-18 | 2018-19 | Change from 2017-18 Dollar Change | Change from 2017-18 Percent Change |
|---|---|---|---|---|
| Legislative, Judicial, Executive | $3,397 | $4,037 | $640 | 18.8% |
| Business, Consumer Services & Housing | 404 | 430 | 26 | 6.4% |
| Transportation | 232 | 239 | 7 | 3.0% |
| Natural Resources | 3,506 | 3,452 | -54 | -1.5% |
| Environmental Protection | 214 | 110 | -104 | -48.6% |
| Health and Human Services | 35,664 | 38,865 | 3,201 | 9.0% |
| Corrections and Rehabilitation | 11,687 | 11,976 | 289 | 2.5% |
| K-12 Education | 54,005 | 55,833 | 1,828 | 3.4% |
| Higher Education | 15,123 | 15,693 | 570 | 3.8% |
| Labor and Workforce Development | 147 | 123 | -24 | -16.3% |
| Government Operations | 1,134 | 1,813 | 679 | 59.9% |
| General Government: | | | | |
| Non-Agency Departments | 785 | 1,076 | 291 | 37.1% |
| Tax Relief/Local Government | 433 | 466 | 33 | 7.6% |
| Statewide Expenditures | 315 | 3,449 | 3,134 | 994.9% |
| **Total** | **$127,046** | **$137,562** | **$10,516** | **8.3%** |

Note: Numbers may not add due to rounding.

Figure SUM-03

**2018-19 Total State Expenditures by Agency**

(Dollars in Millions)

| | General Fund | Special Funds | Bond Funds | Totals |
|---|---|---|---|---|
| Legislative, Judicial, Executive | $4,037 | $3,820 | $264 | $8,121 |
| Business, Consumer Services & Housing | 430 | 1,194 | 352 | 1,976 |
| Transportation | 239 | 13,497 | 636 | 14,372 |
| Natural Resources | 3,452 | 1,718 | 1,242 | 6,412 |
| Environmental Protection | 110 | 3,708 | 172 | 3,990 |
| Health and Human Services | 38,865 | 24,409 | - | 63,274 |
| Corrections and Rehabilitation | 11,976 | 2,909 | - | 14,885 |
| K-12 Education | 55,833 | 106 | 656 | 56,595 |
| Higher Education | 15,693 | 173 | 336 | 16,202 |
| Labor and Workforce Development | 123 | 739 | - | 862 |
| Government Operations | 1,813 | -309 | 7 | 1,511 |
| General Government | | | | |
| Non-Agency Departments | 1,076 | 1,859 | 33 | 2,968 |
| Tax Relief/Local Government | 466 | 2,593 | - | 3,059 |
| Statewide Expenditures | 3,449 | 1,577 | 2 | 5,028 |
| **Total** | **$137,562** | **$57,993** | **$3,700** | **$199,255** |

Note: Numbers may not add due to rounding.

Figure SUM-04

**General Fund Revenue Sources**

(Dollars in Millions)

| | 2017-18 | 2018-19 | Change from 2017-18 Dollar Change | Change from 2017-18 Percent Change |
|---|---|---|---|---|
| Personal Income Tax | $91,971 | $95,009 | $3,038 | 3.3% |
| Sales and Use Tax | 25,384 | 26,674 | 1,290 | 5.1% |
| Corporation Tax | 11,246 | 12,248 | 1,002 | 8.9% |
| Insurance Tax | 2,514 | 2,576 | 62 | 2.5% |
| Alcoholic Beverage Taxes and Fees | 371 | 377 | 6 | 1.6% |
| Cigarette Tax | 67 | 65 | -2 | -3.0% |
| Motor Vehicle Fees | 27 | 27 | 0 | 0.0% |
| Other | 942 | 894 | -48 | -5.1% |
| **Subtotal** | **$132,522** | **$137,870** | **$5,348** | **4.0%** |
| Transfer to the Budget Stabilization Account/Rainy Day Fund | -2,697 | -4,357 | -1,660 | 61.5% |
| **Total** | **$129,825** | **$133,513** | **$3,688** | **2.8%** |

Note: Numbers may not add due to rounding.

Figure SUM-05

**2018-19 Revenue Sources**

(Dollars in Millions)

| | General Fund | Special Funds | Total | Change From 2017-18 |
|---|---|---|---|---|
| Personal Income Tax | $95,009 | $2,225 | $97,234 | $3,211 |
| Sales and Use Tax | 26,674 | 12,041 | 38,715 | 2,073 |
| Corporation Tax | 12,248 | - | 12,248 | 1,002 |
| Highway Users Taxes | - | 7,691 | 7,691 | 788 |
| Insurance Tax | 2,576 | - | 2,576 | 62 |
| Alcoholic Beverage Taxes and Fees | 377 | - | 377 | 7 |
| Cigarette Tax | 65 | 1,992 | 2,057 | -53 |
| Motor Vehicle Fees | 27 | 9,330 | 9,357 | 1,013 |
| Other Regulatory Fees | 2 | 8,575 | 8,577 | -1,134 |
| Other | 892 | 15,571 | 16,463 | 295 |
| **Subtotal** | **$137,870** | **$57,425** | **$195,295** | **$7,264** |
| Transfer to the Budget Stabilization Account/Rainy Day Fund | -4,357 | 4,357 | 0 | 0 |
| **Total** | **$133,513** | **$61,782** | **$195,295** | **$7,264** |

Note: Numbers may not add due to rounding.

# K-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 1,200 charter schools provides instruction in English, mathematics, history, science, and other core competencies.

The May Revision includes total funding of $96.2 billion ($57.4 billion General Fund and $38.8 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 these funds to support all students attending K-12 public schools in California.

Relative to the Governor's Budget, Proposition 98 funding at May Revision is up by $252 million in 2016-17, $407 million in 2017-18, and $68 million in 2018-19. This assumes that average daily attendance remains flat. These changes are largely due to increases in General Fund revenues ($1.3 billion in 2016-17, $3.5 billion in 2017-18, and $3.1 billion in 2018-19 over Governor's Budget), an update to the projected per capita personal income in 2018-19, and a reduction in

Proposition 98 maintenance factor payments. The Proposition 98 maintenance factor accounts for lower past year Proposition 98 funding levels, which the formula generates when state revenues do not keep pace with the state's economy, with the requirement that funding be restored in future years. At the beginning of this Administration, the maintenance factor balance was $11 billion, but this balance has been paid down over time, and at the Governor's Budget, the outstanding maintenance factor was $320 million. At May Revision, primarily as a result of the increase in revenues, the Budget completely eliminates the maintenance factor balance in 2017-18.

## K-12 Funding Priorities

The May Revision proposes to use 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 fully funding the Local Control Funding Formula. The formula provides local flexibility on spending decisions and additional funding for increased or improved services for students most in need of these resources in an effort to narrow the achievement gap.
The May Revision increases funding for the formula by an additional $320 million, enough to fund the projected statutory cost-of-living adjustment of 2.71 percent, as well as provide a $166 million increase to the formula base, to increase the formula by a total of 3 percent. These additional resources build upon the $3 billion provided in the Governor's Budget to fully fund the formula in 2018-19. These additional funds will support core programs and services, as well as other key local investments and priorities, and provide substantial resources to accommodate increasing costs, including rising employee benefit costs. According to the Legislative Analyst, since the enactment of the CalSTRS funding plan in 2014, CalSTRS and CalPERS contribution requirements for K-12 local educational agencies have increased by $3 billion. During the same period, funding for the formula has increased by $17.1 billion.

The Governor's Budget proposed almost $1.8 billion in discretionary one-time Proposition 98 funding for school districts, charter schools, and county offices of education. The May Revision proposes an additional $286 million, providing more than $2 billion in total one-time discretionary funding to schools in 2018-19. This funding will be available to further the implementation of state-adopted academic standards, support investments in school safety, make necessary investments in professional development, provide teacher induction for beginning teachers, address infrastructure and deferred maintenance needs, and purchase instructional materials and technology to prepare both students and teachers for success.
The funds provided will offset any applicable mandate reimbursement claims for these entities. These resources, coupled with more than $5.8 billion in one-time Proposition 98 funding provided to schools from 2014-15 to 2017-18 for the same purposes, will reduce the outstanding mandate debt owed to local educational agencies to $972 million, consistent with the

Administration's goal to pay down debt.

## Proposition 98 Certification

Current law requires the Director of Finance, the State Superintendent of Public Instruction, and the Chancellor of the California Community Colleges to agree and certify a final calculation of the Proposition 98 Guarantee within nine months following the close of the fiscal year. That compressed timeframe, differing interpretations of the law, and other issues have resulted in many uncertified years; 2008-09 is the last year the Guarantee was statutorily certified.

Consistent with this Administration's focus on retiring debt and liabilities, the May Revision proposes a revised certification structure that will: (1) certify the Guarantee for the open years of 2009-10 through 2015-16, (2) provide a new mechanism to more quickly certify in subsequent years, (3) increase certainty around the payment of future certification settlements, and (4) provide the state with additional budgeting flexibility.

Under the revised certification structure, at every May Revision, Finance will publish a final calculation of the prior year's Proposition 98 Guarantee, including all relevant factors. The Superintendent, the Chancellor, the Legislature, the public, and other stakeholders will have the opportunity to review and submit comments regarding the certification. If no challenge to the calculation is made by October 1st, the certification becomes final. Any funding in excess of the required minimum level determined through the certification process may be deemed to meet Guarantee obligations in future years. Any additional amount owed would be paid over a specified time period.

As part of this certification proposal, the Administration will rebench the Proposition 98 Guarantee in the 2015-16 fiscal year to reflect the inclusion of additional child care wraparound services that were funded within the Guarantee beginning in 2015-16. To further the certainty that the revised certification process will provide, the Administration also proposes to continuously appropriate funding for the Local Control Funding Formula, including the annual cost-of-living adjustment. Doing so will provide the same level of certainty for budget planning that local educational agencies enjoyed under the previous revenue limit system.

## Community Engagement, Fiscal Transparency, and School Climate

A key principle of local control of public education is the active engagement of students, parents, and communities with local school districts, which encourages fiscal and programmatic decisions that are based on locally-identified student and community needs and that improve student outcomes. The May Revision includes several proposals to increase opportunities for communities and students to engage meaningfully with their local educational agencies.

**Community Engagement Initiative**—The Administration proposes $13.3 million one-time Proposition 98 General Fund to create the Community Engagement Initiative. This program will utilize the statewide system of support to build the capacity of school districts to engage more effectively with local communities, specifically in the development of the Local Control and Accountability Plan (LCAP), with a focus on improving student outcomes.

**Fiscal Transparency**—The Administration proposes to expand upon the Governor's Budget proposal for a budget summary aligning school district expenditures to LCAP strategies to specify that it be parent-friendly, include specific information on how supplemental grants are used to increase and improve services for high-need students, and include graphical representation of information, when possible. These amendments, paired with the Community Engagement Initiative and the Governor's Budget proposal to make the Dashboard more user-friendly, will improve the ability of parents and community members to be partners in the LCAP decision-making process.

**Improving School Climate**—The Administration proposes $15 million one-time Proposition 98 General Fund to expand the state's Multi-Tiered Systems of Support (MTSS) framework to foster positive school climate in both academic and behavioral areas, including, but not limited to, positive behavior interventions and support, restorative justice, bullying prevention, social and emotional learning, trauma-informed practice, and cultural competency. Utilizing the MTSS structure leverages work done by many school districts across the state to disseminate best practices and integrate this work within the statewide system of support.

## K-12 Strong Workforce Program

The Governor's Budget proposed $200 million in ongoing Proposition 98 General Fund to establish a K-12 component within the Strong Workforce Program to encourage local educational agencies to offer Career Technical Education (CTE) programs that are aligned with needed industry skills and regional workforce development efforts. This proposal complements the 2.6-percent base grant adjustment that is included in the Local Control Funding Formula for grades 9-12 to account for the higher cost of providing CTE programs at the high school level. The May Revision continues to utilize the Strong Workforce Program as proposed in January, but amends the proposal to clarify important elements of this K-12 program, including:

- Clarifying that grant decisions for the K-12 component will be made exclusively by the K-12 Selection Committee.
- Clarifying the requirements that apply to the new K-12 component of the Strong Workforce Program.
- Building in a role for the Technical Assistance Providers established under the California Career Pathways Trust Program, and further clarifying roles and responsibilities of the Workforce Pathway Coordinators.
- Providing additional resources to consortia for administering the regional grant process, including resources to support the K-12 Selection Committee duties.

## Other K-12 Budget Issues

Significant Adjustments:

- English Language Proficiency Assessments—An increase of $27.3 million one-time Proposition 98 General Fund to convert the English Language Proficiency Assessment for California (ELPAC) from a paper-based to a computer-based assessment, and to develop a computer-based alternative ELPAC for children with exceptional needs.
- Charter School Facility Grant Program—An increase of $21.1 million one-time Proposition 98 General Fund in 2017-18 and a decrease of $3.6 million Proposition 98 General Fund in 2018-19 to align available funding with estimated program participation.
- Federal Restart Grant—An increase of $13.9 million one-time federal funds to assist local educational agencies with expenses related to reopening schools impacted by the Northern California and Southern California wildfires of October and December 2017.
- Early Math Initiative—An increase of $11.8 million one-time federal funds to support additional early math resources, including professional learning and coaching for educators, as well as additional math learning opportunities for pre-K through grade 3 children.
- California Collaborative for Educational Excellence—An increase of $5 million Proposition 98 General Fund to align resources with updated estimated costs of services to be provided by the Collaborative in 2018-19.
- Fiscal Crisis and Management Assistance Team (FCMAT) Support—An increase of $972,000 Proposition 98 General Fund, which will allow FCMAT to coordinate with county offices of education to offer more proactive and preventive services to fiscally distressed

school districts, specifically those with a qualified interim budget status (school districts that may not meet their financial obligations in the current year or subsequent two years).

- Local Property Tax Adjustments—An increase of $137.2 million Proposition 98 General Fund in 2017-18 and $278.1 million Proposition 98 General Fund in 2018-19 for school districts, special education local plan areas, and county offices of education as a result of lower offsetting property tax revenues in both years.
- Fire-Related Property Tax Backfill—An increase of $12.3 million Proposition 98 General Fund in 2017-18 and $17.8 million Proposition 98 General Fund in 2018-19 to backfill lost property tax revenue for K-12 schools impacted by last fall's wildfires.
- Average Daily Attendance—An increase of $46.8 million Proposition 98 General Fund in 2017-18 and $42.6 million Proposition 98 General Fund in 2018-19 for school districts, charter schools, and county offices of education under the Local Control Funding Formula as a result of increased caseload costs in the 2016-17 fiscal year.
- Categorical Program Cost-of-Living Adjustments—An increase of $10.6 million Proposition 98 General Fund to selected categorical programs for 2018-19 to reflect a change in the cost-of-living factor from 2.51 percent at the Governor's Budget to 2.71 percent at the May Revision.
- Categorical Program Growth—An increase of $357,000 Proposition 98 General Fund for selected categorical programs, based on updated estimates of average daily attendance.

## Child Care and State Preschool

The state funds nine child care and early education programs as well as dozens of other programs that support child care quality and access, including family resource and referral agencies and local child care planning councils. These programs are administered by the Department of Education and the Department of Social Services. Families can access child care and early education subsidies through providers that contract directly with the Department of Education, local educational agencies, or through vouchers from county welfare departments or alternative payment program agencies.

Significant Adjustments:

- CalWORKs Stage 2 and Stage 3 Child Care—A net increase of $104 million non-Proposition 98 General Fund in 2018-19 to reflect increases in the number of CalWORKs child care cases and cost of care. Total costs for Stages 2 and 3 are $559.1 million and $398 million, respectively.

- Cost-of-Living Adjustment—An increase of $2.2 million Proposition 98 General Fund and $1.8 million non-Proposition 98 General Fund to reflect a change in the cost-of-living factor from 2.51 percent at the Governor's Budget to 2.71 percent at the May Revision.
- Inclusive Early Education Expansion Program—A decrease of $42.2 million federal TANF to remove one-time funds that are no longer available for this program. A corresponding increase of $42.2 million one-time Proposition 98 General Fund is provided to backfill the reduced TANF funding.

# Higher Education

Higher Education includes the California Community Colleges (CCC), the California State University (CSU), the University of California (UC), the Student Aid Commission, and several other entities. The Budget includes total funding of $33.9 billion ($18.8 billion General Fund and local property tax and $15.1 billion other funds) for all higher education entities in 2018-19.

## California Community Colleges

The CCCs are the largest system of higher education in the nation, serving roughly one-quarter of the nation's community college students, or approximately 2.1 million students. The CCCs provide basic skills, vocational, and undergraduate transfer education with 72 districts, 114 campuses, and 78 educational centers. In 2016-17, the community colleges awarded more than 81,000 certificates and 139,000 degrees and transferred more than 106,000 students to four-year institutions.

### Student-Focused Funding Formula

The Governor's Budget proposed a new student-focused funding formula for general purpose apportionments that reflected the following core components: (1) a base grant largely comprised of a funding rate per Full-Time Equivalent Student (FTES), (2) a supplemental grant based on a funding rate per low-income student, and (3) a student success incentive grant comprised of a funding rate per degree, certificate, and award granted to a student.

The proposed student-focused funding formula also included a hold harmless provision that ensured that in 2018-19 and 2019-20, no district would receive less funding than it received in 2017-18.

Since the release of the Governor's Budget, the CCC Chancellor's Office has engaged college leaders and executives and other stakeholders on the proposed formula. The May Revision proposes the following adjustments in response to this feedback and recommendations by the Chancellor's Office:

- Formula Framework—The revised components of the Student-Focused Funding Formula reflect the distribution of 60 percent as a base funding allocation, 20 percent as a supplemental funding allocation, and 20 percent as a student success incentive funding allocation. Non-credit FTES, including career development and college preparation FTES, are not included in the formula and are funded at existing rates. Further, the base funding allocation calculation reflects the use of a three-year rolling average to protect districts from enrollment swings and the peaks and valleys of the economic cycle.
- Supplemental Metrics—The revised components of the supplemental funding allocation reflect the number of low-income students over the age of 25 receiving a College Promise Grant fee waiver, specified undocumented students qualifying for resident tuition, and the total number of students receiving a Pell grant.
- Student Success Incentive Metrics—The revised components of the student success incentive funding allocation include completion of associate degrees and certificates over 18 units, Associates Degrees for Transfer (ADTs), successful transfer to four-year institutions, completion of transfer-level math and English courses in the first year, obtaining a regional living wage within 12 months of completing a degree or certificate program, and successfully completing nine units of career technical education courses. Additionally, the revised student success incentive funding allocation reflects an allocation based upon the successful outcomes of economically disadvantaged students.
- Hold Harmless—The revised hold harmless provision ensures that no district will receive less in both 2018-19 and 2019-20 than it received in 2017-18. Thereafter, each district would be held harmless to its 2017-18 marginal rate of funding. Additionally, the May Revision proposes $104 million one-time Proposition 98 General Fund to provide one-time discretionary resources to districts whose year-over-year increase in general purpose apportionment funding would be less than 2.71 percent (the budget year's cost-of-living adjustment).

The Governor’s Budget also directed the Chancellor’s Office to consult with stakeholders and develop a proposal for the May Revision that would consolidate categorical programs. Based on recommendations from the Chancellor's Office, the May Revision proposes to integrate the Student Success and Support Program, Student Equity Program, and the Student Success for Basic Skills Program into a block grant program. These programs all target similar students, and consolidation will give districts enhanced flexibility to serve them.

## Online College

The Governor's Budget proposed the creation of an online college to provide quality, affordable, and flexible educational opportunities for working adults without a postsecondary credential to improve their economic mobility. As proposed, the online college would design industry-valued credentials that lead to wage gain or promotion, delivered through competency-based education to recognize the skills students bring to community colleges and allow for flexible start-times and other supports. The first two pathways developed by the college would be an information technology support credential program and a medical coding credential program. CalWORKs employment support services funding would provide some students with a laptop, internet access, and books needed to participate in California Online Community College courses, as referenced in the Health and Human Services Chapter.

The May Revision proposes the following clarifications:

**Governance**—The Board of Governors would serve as the governing board of the online community college. The Chancellor and the Board of Governors would choose the president of the online college and the college's president would manage and control the operations of the college. Further, the president of the online college would establish an advisory council, which would include representatives from local trustees and employees of the college, to advise him or her on issues related to the college.

**Collective Bargaining**—The faculty and classified employees of the online college would be represented for the purposes of collective bargaining. To accomplish this, the online college would partner with an existing district for the purposes of establishing a collective bargaining agreement. The online college's president would retain the authority to recommend staff for hire and to assign and direct staff workload.

**Student Success**—The online college would report on outcome measures similar to all other community colleges. To provide greater accountability, the online college would provide a comprehensive status report in its third year of operation regarding student outcomes and the college's progress on reaching working adults. The college would be required to share promising practices and processes with California's 114 traditional community colleges. Additionally, provisions added to the proposed legislation would require the college to comply with disability and accessibility requirements, develop a process for recording and addressing complaints, and report back to the Legislature on compliance with these requirements.

**Accreditation**—The president of the online college would be responsible for commencing the accreditation process upon enrollment of the college's first cohort of students. While the college is seeking accreditation, the Workforce Development Board would certify that programs offered by the online college have job market value. The proposed legislation will direct the college to explore a process for allowing students to retroactively obtain credit units upon demonstrated mastery of competencies for programs completed after the college becomes accredited.

**Curriculum**—The curriculum developed by the online college and its faculty would have the same academic protections granted to all curricula developed by other community college faculty. The proposed legislation will clarify the intent of the online college to create unique content and not duplicate content offered by local colleges. The faculty of the online college would also review the Online Education Initiative protocols for online content and adopt as appropriate.

Significant Adjustments:

- Apportionments—An increase of $73.7 million Proposition 98 General Fund, which includes the following:
    - An increase of $46.9 million Proposition 98 General Fund to reflect the amount of FTES funding earned back by community college districts that declined in enrollment during the previous three years.
    - An increase of $14.9 million Proposition 98 General Fund to reflect unused growth provided in 2016-17.
    - An increase of $11.9 million Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 2.51 percent to 2.71 percent.
- Discretionary Resources for Specified Districts—An increase of $104 million one-time Proposition 98 General Fund to provide limited-term discretionary resources to districts whose year-over-year increase in general purpose apportionment funding would be less than 2.71 percent.
- Financial Aid Awards—An increase of $7.8 million Proposition 98 General Fund for the proposed Student Success Completion Grant to reflect an increased estimate of students.
- Financial Aid Technology Improvements—An increase of $13.5 million one-time and $5 million ongoing Proposition 98 General Fund to upgrade colleges' financial aid management systems for more efficient processing.

- Apprenticeships—An increase of $4.8 million ongoing Proposition 98 General Fund for increased reimbursements to K-12 and community college-sponsored apprenticeship programs and an increase of $5.9 million one-time Proposition 98 General Fund to backfill shortfalls in Related and Supplemental Instruction hours in the prior years.
- Open Educational Resources—An increase of $6 million one-time Proposition 98 General Fund to expand open educational resources.
- NextUp Program Augmentation—An increase of $5 million Proposition 98 General Fund to expand the NextUp Program, which supports current and former foster youth, at 20 community college districts.
- K-12 Strong Workforce Program—An increase of $2 million Proposition 98 General Fund to support the consortia administrative costs associated with the K-12 Strong Workforce Program, as referenced in the K-12 Education Chapter.
- Adult Education Block Grant Program—An increase of $1 million Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 2.51 percent to 2.71 percent in 2018-19.
- Course Identification Numbering System—An increase of $685,000 one-time Proposition 98 General Fund to support a course identification numbering system.
- Categorical Program Cost-of-Living Adjustment—An increase of $581,000 Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 2.51 percent to 2.71 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.
- Deferred Maintenance—A decrease of $131.7 million one-time Proposition 98 General Fund for deferred maintenance, instructional equipment, and specified water conservation projects to reflect alternative spending priorities.
- Local Property Tax Adjustment—An increase of $53 million Proposition 98 General Fund as a result of decreased offsetting local property tax revenues.
- Student Enrollment Fee Adjustment—A decrease of $12.8 million Proposition 98 General Fund as a result of increased offsetting student enrollment fees.

## University of California

Consisting of ten campuses, the UC is the primary institution authorized to independently award doctoral degrees and professional degrees. The UC educates approximately

270,000 undergraduate and graduate students and receives the highest state subsidy per student among the state's three public higher education segments.

## Update on the Agreement with the University of California

In 2015, the Governor and the UC President reached an agreement in which the state would provide the UC stable funding in exchange for student-focused reforms and efforts to reduce its cost structure. Components of the agreement included piloting new technologies to enhance student learning and UC fiscal administration, increasing transfer student access and improving the transfer process, and efforts to reduce costs for students.

At the time of the passage of the 2017 Budget Act, two of these components—the completion of three activity-based costing pilots and each campus achieving a ratio of one entering transfer student for every two new freshmen students—had yet to be accomplished. In light of the report by the State Auditor on the UC Office of the President released in April 2017, the enacted budget conditioned the release of $50 million from the UC's appropriation. These conditions included the UC meeting the framework goals, implementing State Auditor recommendations, halting supplemental retirement payments to new Senior Management Group employees, and releasing additional information regarding the UC Office of the President's finances.

The UC has completed activity-based costing pilots, implemented most of the reforms recommended by the State Auditor, adopted a policy ending supplemental retirement payments, and released additional information on system wide and presidential initiatives. Although two campuses are expected to be above the expected transfer ratio, progress has been made towards this goal and the UC President has signed a memorandum of understanding with the CCC Chancellor's Office to streamline the transfer process for students and build upon the existing ADT process. This agreement represents a bold commitment to improve the transfer process between the two systems and increasing ADT portability for students.

The UC and the State Auditor provided evidence regarding the 2017 conditions to the Director of Finance. Several items are pending approval by the Regents. While the May Revision assumes the release of the $50 million, the Director will determine the release of funds after the Regents act in May.

Significant Adjustments:

- Tuition's Impact on the Cal Grant and Middle Class Scholarship Programs—Existing practice adjusts the Cal Grant and Middle Class Scholarship tuition award for students attending the UC to reflect the amount of tuition charged by the UC. If the UC were to increase tuition for the 2018-19 fiscal year by 2.5 percent, the state's Cal Grant and Middle Class Scholarship costs would increase by approximately $22.3 million and $574,000, respectively. To address these potential costs, the May Revision proposes adding budget bill language authorizing the Director to reduce the UC's primary appropriation by the amount of estimated Cal Grant and Middle Class Scholarship program cost increases should a tuition increase be implemented in 2018-19.
- Deferred Maintenance—An increase of $100 million one-time General Fund to support deferred maintenance projects, as referenced in the Statewide Issues and Various Departments Chapter.
- Mental Health Graduate Medical Education—An increase of $55 million one-time General Fund to support psychiatric graduate medical education programs serving Health Professional Shortage Areas or Medically Underserved Areas in rural portions of the state. This is part of a larger package of mental health proposals, as referenced in the Health and Human Services Chapter.
- Anti-Bias Training at Campuses—An increase of $1.2 million one-time General Fund to administer a two-year pilot program to provide anti-bias training to administrators, faculty, staff, and student leaders at campuses of the UC and the CSU.
- Center for Global Conflict and Cooperation—An increase of $1 million ongoing General Fund to support the operations of the Institute for Global Conflict and Cooperation.

## California State University

The CSU serves over 470,000 students across 23 campuses and receives funding from a variety of sources, including state General Fund, federal funds, lottery funds, and student tuition and fees. The May Revision maintains the $92.1 million investment in the CSU proposed at the Governor's Budget and the expectation that these funds be used to make progress on the Graduation Initiative.

Significant Adjustments:

- Tuition's Impact on the Cal Grant and Middle Class Scholarship Programs—Existing practice adjusts the Cal Grant and Middle Class Scholarship tuition award for students attending the CSU to reflect the amount of tuition charged by the CSU. If the CSU were to increase tuition for the 2018-19 fiscal year by 4 percent, the state's Cal Grant and Middle Class Scholarship costs would increase by approximately $23 million and $3 million, respectively. To address these potential costs, the Administration proposes adding budget bill language authorizing the Director to reduce the CSU's primary appropriation by the amount of estimated Cal Grant and Middle Class Scholarship program cost increases should a tuition increase be implemented in 2018-19.
- Deferred Maintenance—An increase of $100 million one-time General Fund to support deferred maintenance projects, as referenced in the Statewide Issues and Various Departments Chapter.

## California Student Aid Commission

The California Student Aid Commission administers financial aid programs, including the Cal Grant program and the Middle Class Scholarship Program.

Significant Adjustments:

- Cal Grant Program Costs—An increase of $58.4 million General Fund in 2018-19 to account for the following:
    - Participation Estimates—An increase of $29.3 million in 2018-19 to reflect an increase in the number of new recipients in 2017-18. The May Revision also reflects increased costs of $76.3 million in 2017-18 and savings of $4.1 million in 2016-17 to update prior estimates.
    - Temporary Assistance for Needy Families (TANF) Reimbursements—A decrease of $29.1 million in 2018-19, which increases the amount of General Fund needed for program costs by a like amount. Combined with 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 2018-19.

- Tuition Award for Students at Private Nonprofit Institutions—The May Revision proposes to adjust the ADT annual admissions goal required to maintain the maximum Cal Grant tuition award for new students attending private nonprofit institutions at $9,084 to 2,000 ADT students admitted in 2018-19, 3,000 students admitted in 2019-20, and 3,500 students admitted in 2020-21 and thereafter.

## Hastings College of the Law

Hastings College of the Law is affiliated with the UC system, but is governed by its own Board of Governors. Located in San Francisco, it primarily serves students seeking a Juris Doctor degree, but also has masters programs. In 2016-17, UC Hastings enrolled 951 full-time equivalent students. Of these, 919 were JD students.

Since the end of the Great Recession, UC Hastings College has received stable ongoing funding increases. In turn, tuition at UC Hastings has been flat for six years. This has kept a quality legal education within reach for hundreds of Californians. However, UC Hastings faces the cost of implementing the UC Path payroll, accounting, and human resource modernization project—a significant cost at a time when tuition has been held steady and Hastings has been spending reserve funds to maintain tuition discounts.

Significant Adjustments:

- Funds for UC Path—An increase of $1.5 million one-time General Fund to support implementation of the UC Path project at Hastings College of the Law.
- Deferred Maintenance—An increase of $1 million one-time General Fund to support deferred maintenance projects, as referenced in the Statewide Issues and Various Departments Chapter.

## California State Library

The California State Library serves as the central reference and research library for the Governor and Legislature. Additionally, the State Library provides critical assistance to the 184 library jurisdictions and nearly 1,200 libraries across the state.

Significant Adjustments:

- Collection Protection Activities—An increase of $663,000 General Fund to purchase emergency supplies, restore damaged books, and procure a vault to further protect the library's collection.
- California Newspaper Project—An increase of $430,000 General Fund ongoing to support the California Newspaper Project, located at UC Riverside.
- Digital Preservation Activities—An increase of $195,000 General Fund ongoing to preserve information on state websites four times each year and records collected by the State Archivist.

# Health and Human Services

The Health and Human Services Agency oversees departments and other state entities that provide health and social services to California's vulnerable and at-risk residents.

The May Revision includes $158.7 billion ($38.9 billion General Fund and $119.8 billion other funds) for all health and human services programs, an increase of $1.5 billion General Fund compared to the Governor's Budget.

## Mental Health Initiatives

The state's mental health system includes services provided by both the state and counties. Most mental health services are provided in the community by counties, with significant state and federal funding participation. Funding sources, totaling approximately $8 billion annually, include 1991 Realignment, 2011 Realignment, the Mental Health Services Act (Proposition 63), as well as General Fund and matching federal funds through the Medi-Cal program. Additionally, mental health services are provided at the Department of State Hospitals and the California Department of Corrections and Rehabilitation.

Despite substantial funding and some recent efforts to enhance mental health services, many challenges remain in the mental health system. These include continued growth in incompetent to stand trial referrals, increasing interactions between individuals with mental illness and the criminal justice system, and the prevalence of mental illness (and co-occurring substance use disorder issues) in California's homeless population.

In recognition of these challenges, especially for incompetent to stand trial referral rates, the Governor’s Budget included proposals that focused on expanding community placements and services rather than incarceration or referral to a state hospital. Targeted funding was provided to Los Angeles County (about $15 million General Fund when fully operational), the county with the highest number of severely mentally ill individuals and the majority of referrals to state hospitals. The Governor's Budget also included $100 million General Fund over three years for the expansion and development of county diversion programs with the majority of funding going to the 15 counties with the highest referrals to state hospitals. To support this effort, the Governor's Budget also included $5 million from Mental Health Services Act funds over two years to assist counties in developing innovation plans that incorporate new approaches to the diversion of mentally ill individuals away from law enforcement to community-based programs.

Other efforts incorporated into existing safety net programs are not included in the previously mentioned mental health totals, such as the state's 1115 Medicaid waiver, which includes the Medi-Cal Whole Person Care Pilot, to coordinate the health, behavioral health, and social services needs of Medi-Cal beneficiaries. This pilot program provides $1.5 billion in additional federal funds over five years to coordinate services for vulnerable Medi-Cal beneficiaries who have been identified as frequent users of multiple systems and have poor health outcomes. Of the 25 pilots, 23 target homeless populations or those at risk of homelessness and 13 of those specifically target (though all have a focus on) individuals with mental health and/or substance use disorder conditions—all with the goal of providing comprehensive, coordinated care for the beneficiary and better health outcomes.

## Additional Investments in the Mental Health System

The May Revision includes additional resources to both build upon earlier efforts and strengthen cross-sector collaboration to help counties support identification, treatment, and services at various points in the mental health system. These targeted investments will enhance and encourage local mental health efforts and benefit other program areas by decreasing homelessness and reducing the number of mentally ill individuals involved in the criminal justice system—including the number of individuals incarcerated in county jails and state prisons, as well as those awaiting placement in state hospitals.

**No Place Like Home**—The May Revision proposes placing the No Place Like Home program on the November 2018 ballot. Voters will have an opportunity to validate the No Place Like Home program, which allocates $2 billion from Mental Health Services Act funds to provide housing for individuals who are in need of mental health services and are experiencing homeless or at risk of homelessness. The Department of Housing and Community Development will issue an initial Notice of Funding Availability prior to November and make awards before the end of the calendar year, contingent on voter approval of the measure.

**Children's Mental Health Mandate Repayment**—The May Revision includes repayment of approximately $254 million plus interest for repealed state mandates related to services provided by counties to seriously emotionally disturbed children (AB 3632), as referenced in the Statewide Issues and Various Departments Chapter. The costs were incurred by the counties between 2004 and 2011. The Administration expects counties to use this funding for early intervention and prevention of mental health services for youth, with an emphasis on teens.

**Homeless Mentally Ill Outreach and Treatment**—The May Revision proposes a one-time augmentation of $50 million for the Department of Health Care Services to provide counties with targeted funding for multi-disciplinary teams to support intensive outreach, treatment and related services for homeless persons with mental illness, as referenced in the Statewide Issues and Various Departments Chapter. The funding allocation will be targeted to local entities based on the principles of Chapter 518, Statutes of 2000 (AB 2034) and Chapter 617, Statutes of 1999 (AB 34). Counties are encouraged to match these funds with local mental health funding as well as federal matching funds, where appropriate. This type of intervention is expected to result in earlier identification of mental health needs, prevention of criminal justice involvement, and improved coordination of care for this population at the local level.

**Graduate Medical Education**—To address the lack of mental health professionals, the May Revision proposes an increase of $55 million one-time General Fund to support psychiatric graduate medical education programs serving Health Professional Shortage Areas or Medically Underserved Areas in rural portions of the state, as referenced in the Higher Education Chapter.

**Oversight and Planning**—The May Revision proposes $6.7 million for 48 staff at the Department of Health Care Services to support oversight of county mental health programs and review of Mental Health Services Act expenditures, as well as planning efforts for system and data improvements to support the evaluation of county mental health programs.

## Department of Health Care Services

Medi-Cal, California's Medicaid program, is administered by the Department of Health Care Services. 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, dental, home and community-based services, and medical equipment. The Department 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.

Medi-Cal was established more than 50 years ago, but has changed significantly in recent years. Since 2011, the number of individuals receiving coverage through Medi-Cal and the Children's Health Insurance Program (CHIP) increased from 8.5 million to 13.3 million. Compared to the 2011 Budget Act, total program costs increased from $45.5 billion ($14.7 billion General Fund) to an estimated $103.9 billion ($22.9 billion General Fund) in 2018-19.

Unlike most programs, Medi-Cal operates on a cash, rather than an accrual, accounting basis. Both the rapid expansion of the program and federal constraints have significantly increased the difficulty and uncertainty of budgeting for this program on a cash basis.

Many of the complexities in forecasting program expenditures have resulted in a Medi-Cal shortfall compared to the 2017 Budget Act that now totals $830.5 million General Fund. This is an increase of $286.9 million compared to the Governor's Budget. As reflected in Figure HHS-01, there are many adjustments within the Medi-Cal estimate that contribute to this change.

Figure HHS-01

**Significant General Fund Adjustments**

**2017-18**

(Dollars in Millions)

| Category | Program | Governor's Budget Expenditures | May Revision Expenditures | Impact on General Fund |
|---|---|---|---|---|
| Financing Complexities | Drug Rebates | -$1,106.7 | -$831.4 | $275.3 |
| | Managed Care Organization Taxes | -2,175.2 | -1,747.0 | 428.2 |
| | Managed Care Financing | 10,187.4 | 10,009.8 | -177.6 |
| Federal Actions | Hospital Quality Assurance Fee | -851.8 | -1,328.9 | -477.1 |
| | Children's Health Insurance Program Reauthorization | 640.2 | 396.7 | -243.5 |
| | Deferred Claims | 71.7 | 754.0 | 682.3 |
| | Base Program[1/] | 13,243.9 | 13,043.2 | -200.7 |
| **Total General Fund** | | **$20,009.5** | **$20,296.4** | **$286.9** |

[1/] Includes net adjustments for various policies in the Medi-Cal May 2018 Local Assistance Estimate.

These changes are primarily attributed to:

- Drug Rebates—Savings are lower due primarily to retroactive payments to the federal government tied to the rapid changes allowed under the Affordable Care Act.

- Managed Care Organization Tax—Offsets to General Fund costs are lower due to updated caseload projections and rate adjustments that reduced the tax on health plans.
- Managed Care Financing—Costs have decreased since the Governor's Budget due to lower than projected caseload, retroactive rate adjustments, and lower Hepatitis C costs.
- Hospital Quality Assurance Fee—Delays in federal approval of this fee changed the timing of anticipated revenue, offsetting additional current year costs.
- CHIP Reauthorization—In December 2017, Congress reauthorized a short-term extension of enhanced federal funding. Through two actions at the end of January and early February 2018, the federal government passed a ten-year extension, continuing the enhanced 88-percent federal share of costs through September 30, 2019. The enhanced funding then decreases incrementally over time to the historic sharing ratio of 65 percent federal funds and 35 percent state funds. These reductions in federal funding will increase General Fund costs beginning in 2019-20. In the short term, the reauthorization results in a combined two-year, General Fund decrease of $898.1 million in 2017-18 and 2018-19 compared to the Governor's Budget.
- Deferred Claims— Increased costs as a result of new federal requirements, which require the state to repay disputed claims while the Department works to substantiate them.

Significant Adjustments:

- Specialty Mental Health Services Federal Audit Repayment—A recent audit by the U.S. Department of Health and Human Services, Office of the Inspector General is expected to result in the disallowance of approximately $180.7 million in federal Medi-Cal claims for county specialty mental health services. These funds will initially be paid by the state in 2018-19 with repayments from counties occurring over the next four years to prevent the removal of significant local funds from the mental health delivery system in a single year.
- Proposition 56—Updated revenues from this tobacco tax increased slightly compared to the estimate in January. Net revenues after backfill amounts total $1.3 billion in 2018-19, an increase of $32 million since the Governor's Budget. The May Revision forecasts expenditures of $629.9 million in 2018-19 for supplemental payments and rate increases, a decrease of $51.6 million compared to the Governor's Budget. Based on year-to-date expenditures in 2017-18, claims for physicians were lower than expected. However, the May Revision maintains the increase of approximately $163 million for physician payments and $70 million for dental payments in 2018-19. The May Revision also reflects an increase of $55.3 million to support new growth in Medi-Cal in 2018-19. The Administration will

continue to work with the Legislature and stakeholders on a 2018-19 supplemental payment structure for submission to the federal government by September 2018.

- Pharmacy Reimbursement—The May Revision maintains the Administration's proposal to prohibit the use of federal 340B Drug Pricing Program reimbursements within the Medi-Cal program beginning July 1, 2019, to prevent duplicate discounts and overpayments, and reduce drug rebate disputes. The Administration estimates this proposal will result in $16.6 million General Fund savings annually beginning in 2020-21.
- Expand Hepatitis C Treatment Clinical Guidelines—An increase of $70.4 million ($21.8 million General Fund) in 2018-19 to authorize treatment for all patients ages 13 and above with Hepatitis C, regardless of liver fibrosis stage or co-morbidity, except for patients with a life expectancy of less than 12 months. Currently, Medi-Cal authorizes treatment for individuals with stage two or above liver fibrosis, or at any stage if they have a qualifying co-morbid condition.
- California Medicaid Management Information System (CA-MMIS)—An increase of $41.7 million ($9.7 million General Fund) in 2018-19 to provide resources for the existing Medi-Cal fiscal intermediary contracts and the implementation of a modular modernization strategy for the CA-MMIS project.

## 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.

Caseload Adjustments:

- IHSS—The overall cost for IHSS increased by $105.6 million General Fund in 2017-18, and $174.7 million General Fund in 2018-19, due primarily to a projected increase in costs associated with IHSS overtime, average hours per case, and average cost per case. These increases were offset partially by slower caseload growth compared to the prior forecast, with caseload projected to be over 544,000 in 2018-19.

- CalWORKs—A decrease of $37.1 million General Fund and federal Temporary Assistance for Needy Families (TANF) block grant funds in 2017-18 and $34.4 million General Fund and TANF in 2018-19. This reflects updated caseload and average cost per case projections. The total caseload of 406,175 is the lowest level in about 30 years.
- SSI/SSP—A decrease of $21.9 million General Fund in 2017-18 and $34.4 million General Fund in 2018-19 to reflect continued decreases in caseload to approximately 1,246,000 recipients.

### Continuum of Care Reform

As implementation of the foster care reforms outlined in Chapter 773, Statutes of 2015 (AB 403), continues into its second full year, expected savings have eroded. This is due primarily to a slower-than-anticipated decline in congregate care caseload, as well as continued use of the Specialized Care Increments (SCIs) that were expected to decrease as foster care rates increased. This results in General Fund increases of $49.5 million in 2017-18 and $56 million in 2018-19. The May Revision continues to assume counties will reduce SCI payments to reflect the transition from age-based foster care rates to the new home-based family care rate structure beginning in July 2018. Additionally, one-time funding of $3.2 million General Fund is provided to support county efforts in eliminating the backlog of foster care resource family applications that are pending review and approval. An increase of $2.5 million General Fund is also proposed to address county workload associated with implementation of an assessment tool to assess a child's level-of-care needs. Together, these increases will further support the transition to a home-based family care model with improved access to services to support these placements.

In addition to the funding noted above, the May Revision includes an increase of $13.4 million TANF in 2018-19 to provide caregivers with up to six months of emergency assistance payments pending approval as a resource family. Beginning in 2019-20, and annually thereafter, emergency assistance payments will be available for up to three months, as local child welfare agencies and probation departments are expected to eliminate the backlog and complete the resource family approval process within three months of application receipt. The May Revision sets aside $27 million TANF to fund these emergency assistance costs through 2020-21.

### Services to Address Homelessness

The number of homeless individuals in California increased significantly between 2016 and 2017. The May Revision provides additional resources to the state's social services safety net programs to prevent vulnerable Californians from becoming homeless, as referenced in the

Statewide Issues and Various Departments Chapter. The May Revision provides $47.3 million in increased General Fund resources in 2018-19, increasing to $63.7 million in 2019-20, for the following county programs:

- CalWORKs Housing Support Program—An increase of $24.2 million to help CalWORKs families secure permanent housing. With an additional augmentation in 2019-20, the total program funding will increase from $47 million to $95 million annually. This program provides counties with flexibility to address the needs of each family, including move-in assistance, temporary rental subsidies, and intensive case management.
- CalWORKs Homeless Assistance Program—An increase in the daily payment rate for temporary assistance for families who are homeless or face imminent eviction. This program provides up to 16 days of temporary housing each year by issuing eligible families a voucher for either a temporary shelter or hotel/motel. For a family of four, the rate will increase from $65 to $85 beginning January 1, 2019. This daily rate was last increased more than ten years ago. The May Revision includes $8.1 million in 2018-19, increasing to $15.3 million in 2019-20.
- Home Safe Pilot Program—The May Revision proposes $15 million, on a one-time basis, to fund a pilot program within Adult Protective Services. The pilot provides housing-related supports to seniors experiencing homelessness or at risk of losing their homes by providing temporary rental or utility assistance, housing repairs, landlord mediation, and case management. The funding will be available to participating counties over a three-year period with a local match.

## Other Significant Adjustments

- CalWORKs Single Allocation—An increase of $55.8 million TANF in 2018-19 to reflect the adoption of a revised budgeting methodology for county administration of the CalWORKs eligibility determination process. This model recognizes that counties have difficulty adjusting to significant increases and decreases in caseload, and attempts to smooth out the changes to county funding. The methodology: (1) establishes a fixed-base funding level that does not adjust when caseload changes, and (2) includes a variable component that adjusts when caseload increases or decreases by 5 percent or more, compared to the 2018-19 caseload.
- 1991 State-Local Realignment Health Account Redirection (AB 85)—County indigent health savings are projected to increase by $242.7 million in 2018-19. This results in additional 1991 Realignment funds available to offset General Fund costs in CalWORKs.

- IHSS County Administration—An increase of $24 million General Fund in 2018-19 to reflect higher estimates of county workload related to the IHSS program.
- County IHSS Maintenance of Effort—Chapter 25, Statutes of 2017 (SB 90), specified the counties' share of IHSS costs and implemented a revised maintenance-of-effort (MOE) structure, resulting in higher county costs compared to the prior MOE levels. Based on updated revenue projections and redirections, available 1991 Realignment revenues are expected to cover a larger share of the increased MOE costs. When combined with $330 million in state mitigation for 2018-19 and $200 million in 2019-20, this results in no net fiscal impact to counties through 2019-20.
- Expanded Access to Online Community College Education—The May Revision includes additional funding for the development of additional courses in the proposed California Online Community College, as referenced in the Higher Education Chapter. As these courses are developed, additional funding for educational support services within CalWORKs employment services will be provided, consistent with current practice. This includes funding for laptops, internet access, and books needed to participate in these courses. Initial enrollment is anticipated to begin in fall 2019.

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# Public Safety

This Chapter describes items in the May Revision related to California's correctional system and public safety programs.

## Department of Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation incarcerates the most violent felons, supervises those released to 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 total funding of $12.1 billion ($11.8 billion General Fund and $313 million other funds) for the operation of the Department in 2018-19.

### Population

Compared to the Governor's Budget projections, changes in the adult inmate and parole population have resulted in a net decrease of $12.6 million General Fund in 2017-18 and 2018-19 combined. The revised average daily population projections for adult inmates are 130,197 in the current year and 126,890 in the budget year, a decrease of 120 in 2017-18 and 522 in 2018-19. The revised average daily parolee population projection is 46,273 in the current year and 48,535 in the budget year, a decrease of 698 and 1,259 parolees, respectively.

Proposition 57, the Public Safety and Rehabilitation Act of 2016, is estimated to reduce the average daily adult inmate population by approximately 5,800 in 2018-19, and approximately 11,200 in 2020-21. While included in the above population projections, these figures remain preliminary and subject to considerable uncertainty. As of May 3, 2018, the prison population was at 134.6 percent of design capacity, which is below the federal court-ordered population cap of 137.5 percent of design capacity.

The implementation of Proposition 57 and other population reduction measures will allow the Department to eliminate the use of out-of-state beds from its long-term court compliance strategy. Revised estimates include the removal of all inmates from both out-of-state facilities—Mississippi by the end of May 2018 and Arizona by the end of January 2019.

## Employee Training and Inmate Access to Programs

The Department will further its efforts to promote programs that support workforce development to complement investments being made for inmate rehabilitation. Specifically, the May Revision includes:

**Training Initiatives**—$12.9 million General Fund for additional training for peace officers that includes topics such as ethics, sexual harassment, procedural justice, and implicit bias. This proposal also includes specialized training for Special Agents and Investigative Unit staff in criminal investigations, training designed to assist with the transition of officers to supervisory roles, and training to strengthen skills of existing supervisors and managers. This will be achieved by:

- Expanding the Correctional Officer Academy by 1 week to 13 weeks.
- Expanding the annual institution staff off-post training by 8 hours for a total of 48 hours.
- Creating a Command College for Captains, Associate Wardens, Chief Deputy Wardens and Superintendents.
- Utilizing Peace Officer Standards and Training certified courses to train Special Agents and Investigative Services Unit staff.
- Increasing Advanced Supervision training by 1 week to 3 weeks.

**Training for Case Records Staff**—$444,000 General Fund to create a unit that will be responsible for developing and implementing a statewide training plan for sentencing calculations and computations. Given the complexity of recent credit enhancements, this unit will provide continual training and updates to the various systems used to track inmate data and address inconsistencies with manual and computer generated calculations.

The following proposals will provide additional staff to continue enrolling offenders into appropriate rehabilitation programs and safeguard against the redirection of staff responsible for overseeing program delivery to cover unplanned transports.

**Correctional Counselor I Ratios**—$13.5 million General Fund to reduce the current offender to Correctional Counselor I ratio of 150:1 to 135:1 to provide enhanced rehabilitation and program enrollment assistance to the offender population. This results in the addition of 89 Correctional Counselors to focus on core offender counseling needs.

**Medical Guarding and Transportation**—$5.9 million General Fund to provide an equivalent of one additional Correctional Officer at each institution to address higher-than-anticipated medical transports, primarily during third watch, which result in yard or program closures. Officers assigned these duties will be redirected to other work, such as search and escort, when they are not transporting inmates. These resources will enable the Department to mitigate rehabilitative program closures while it undergoes a more comprehensive review of the medical guarding and transportation needs at each institution.

Other Significant Adjustments:

- Health Care Services for Reentry Facilities—$10.8 million General Fund to provide health care to all inmates housed at reentry facilities. The Department is in the process of finalizing an agreement with the Department of Health Care Services to contract with various health care providers for comprehensive medical coverage for inmates at these reentry facilities.
- Court Resentencing Workload—$2 million General Fund to develop a process to expand the utilization of authority under Penal Code section 1170, subdivision (d), allowing the Secretary of the Department to petition courts to resentence inmates who either were erroneously sentenced to terms of imprisonment that are longer than provided for under law or have displayed exceptionally meritorious conduct.
- Overtime Base Adjustment—$16.5 million General Fund to reflect the impact of salary increases on activities budgeted as overtime. Funding for the salary growth for budgeted positions is provided to the Department through the statewide process for bargained salary increases, but overtime is typically not included in that process. The Department supports certain activities entirely through overtime, such as crisis response training, emergency report writing, emergency escapes, and incident response. To provide the Department with an appropriate ongoing overtime funding level, the statewide process will incorporate incremental adjustments beginning in 2019-20.

## Drug and Contraband Interdiction and Medication Assisted Treatment Pilot

Most other states and the Federal Bureau of Prisons search all packages and persons entering prison grounds. To measure the efficacy of such efforts in California prisons—one of the largest state prison systems in the nation—this approach should be tested to determine the effect it has on the introduction of drugs and contraband, as well as overdoses associated with the presence of illegal drugs in prisons.

The Department's drug and contraband program is currently aimed at reducing illegal drugs and contraband entering prisons. The Department has 70 permanent canine teams, with two teams assigned to each institution. The canine teams conduct routine searches of housing units, classrooms, offices, buildings and primary entrance points for contraband, including incoming mail and packages, as well as the institution perimeter, parking lots and vehicles. These efforts are intended to reduce inmate violence, increase safety for staff and inmates, and promote a drug-free rehabilitative environment.

The May Revision includes $9.1 million General Fund to pilot a comprehensive Drug Interdiction program and a Medication Assisted Treatment program at the Substance Abuse Treatment Facility. This proposal includes baggage/parcel and full body scanners at both entrances to deter contraband from entering the prison, and a Medication Assisted Treatment program to treat substance use disorders. The pilot will be operational 24 hours per day, 7 days per week and all staff, volunteers and visitors will be searched prior to entering the prison. Canine teams, using passive dogs trained to detect drugs and contraband, will be present as an additional deterrent. The Medication Assisted Treatment program will complement these efforts and will include access to naltrexone and acamprostate for treatment of alcohol and opiate use disorders.

## Inmate Health Care

The May Revision dedicates $3.2 billion General Fund to health care services programs, resulting in inmates having continued access to mental health, medical and dental care that is consistent with the standards and scope of services appropriate within a custodial environment.

### Hepatitis C Virus Treatment

The Centers for Disease Control and Prevention (CDC) promotes the treatment of Hepatitis C given its role in the opioid epidemic and because Hepatitis C is responsible for more deaths in the United States than any other infectious disease reported to the CDC.

The May Revision includes $105.8 million General Fund annually for three years, beginning in 2018-19, to expand Hepatitis C treatment to all infected inmates in state prison. The court-appointed Federal Receiver overseeing inmate medical care indicates that approximately 22,000 inmates are currently infected with Hepatitis C. Of that number, approximately 2,300 inmates will be treated for the virus in the current year within existing resources, at a cost of about $60 million. The remaining affected inmates will be treated over the next three years. This augmentation is a result of a new protocol implemented by the Receiver in December 2017 that provides treatment to all inmates in any stage of the Hepatitis C Virus. The May Revision extends this protocol to other health care programs, as referenced in the Health and Human Services Chapter.

### Mental Health Psychiatry Registry

The May Revision includes $18.1 million General Fund for contract psychiatry services needed to meet a federal court order to fill at least 90 percent of the state prison system's psychiatry positions. This is one of many staffing efforts the Department has undertaken to increase its ability to fill psychiatry positions. Other efforts implemented over the last few years include increasing use of tele-psychiatry, establishing an onboarding program and exit interviews, beginning the use of Medical Assistants to support psychiatry positions with non-clinical tasks, and expanding the use of a fellowship program.

## Prison Infrastructure

California experienced record levels of rainfall in 2017, and severe storms caused significant damage to prison roofs. Failing prison roofs have resulted in damage to electrical systems and housing units, and interruptions in rehabilitation programs, education programs, and mental health treatment. The Governor's Budget included $119 million to replace roofs at five facilities over a two-year period and $20 million for mold remediation efforts. Based on a revised system-wide estimate of water damage repair costs, the May Revision reduces the Governor's Budget proposal for mold remediation by $11 million in 2018-19. The May Revision also includes $2.5 million to fund the design process for four of the roof replacement projects and adds $22.6 million for the replacement of the roof at the California Correctional Women's Facility in 2019-20. This adjustment results in total funding of $153 million General Fund for roof replacements and mold remediation over the next two fiscal years.

# Department of Justice

As chief law officer of the state, the Attorney General is responsible for seeing that the laws of California are uniformly and adequately enforced. This responsibility is fulfilled through the diverse programs of the Department of Justice, and includes protecting Californians from fraudulent, unfair, and illegal activities.

Significant Adjustments:

- California Sexual Assault Registry—$10 million General Fund to begin implementing Chapter 541, Statutes of 2017 (SB 384), which will replace the existing lifetime sex offender registration systems with a tiered registration system. This initial funding will enable the Department of Justice to develop the necessary information technology planning documents and begin updating the California Sex and Arson Registry System, as well as ancillary systems and the Megan's Law website. Ongoing funding will be included in the 2019-20 Governor's Budget to allow the Department to implement the new system by January 1, 2021, which will include staffing associated with new tiering, exclusion, and termination requests associated with SB 384.
- DNA Identification Fund Backfill—$6 million General Fund on a one-time basis to backfill the decline in fine and fee revenues in the DNA Identification Fund. This funding will enable the Department of Justice to continue processing forensic evidence for client counties at existing levels.
- Bureau of Forensic Services Equipment Replacement—$5.4 million General Fund on a one-time basis to replace critical forensic equipment within the Bureau of Forensic Services.
- Cybercrime Investigation Teams—$5.4 million General Fund to establish two investigation teams to combat cybercrimes, white collar crimes, and human trafficking crimes.
- Cybersecurity Improvements—$2.3 million General Fund to protect and secure information on the Department's data and law enforcement networks throughout California. Specifically, this proposal provides additional resources for the Office of Digital Investigations and the Network Security Unit.
- Illegal Cannabis Enforcement—$14 million Cannabis Tax Fund to create four investigation teams and one interdiction team to combat large-scale illegal cannabis activities, as referenced in the Statewide Issues and Various Departments Chapter.

## State Penalty Fund—Law Enforcement Training

To maintain critical law enforcement training programs, the May Revision restores proposed State Penalty Fund expenditure reductions included in the Governor's Budget. Specifically, the Commission on Peace Officer Standards and Training and the Standards and Training for Local

Corrections programs are now proposed to be funded at their 2017-18 level. Because State Penalty Fund revenues continue to decline, the May Revision shifts the Standards and Training for Local Corrections program ($17.3 million), administered by the Board of State and Community Corrections, to the General Fund. While protecting law enforcement training, this expenditure shift also provides relief to the State Penalty Fund and avoids the need to further reduce victims programs that have also experienced significant State Penalty Fund expenditure reductions in recent years.

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# 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 $10.7 billion ($3.5 billion General Fund) for all programs included in this Agency.

## Climate Resiliency and Adaptation

California has historically been susceptible to wildfires and hydrologic variability. As greenhouse gas emissions continue to accumulate, climate change will intensify extreme weather events such as coastal storm surges, droughts, wildfires, floods and heat waves. Californians are now experiencing first-hand the damaging effects of climate change. Over the past two years, the most severe drought in California’s recorded history was halted by one of the wettest seasons on record, causing significant flood-related damage. Between October and December, the combination of increased fire-prone vegetation from the winter storms and extreme winds triggered the most destructive wildfires in the state’s history.

The May Revision proposes additional investments to enhance the state’s resilience to the impacts of climate change, specifically the risks of wildfires and floods and preserving the state's unique biodiversity.

## Forest Carbon Plan

California's 33 million acres of forestland and its urban forest canopy capture and clean the state's water supply, provide habitat for countless wildlife, cool cities, support local economies, and serve as cultural centers for indigenous and local communities across the state. Forested lands are also the largest land-based carbon sink with trees and underbrush drawing carbon from the atmosphere and storing it in their biomass and in forest soils. Growing evidence, however, suggests these lands will become a source of overall net greenhouse gas emissions if actions are not taken to enhance their health and resilience and reduce the threats they face from wildfire, insects, disease, and a changing climate.

Decades of fire suppression, coupled with drought and the effects of climate warming, have dramatically increased the size and intensity of wildfires and bark beetle infestations and exposed millions of urban and rural residents to unhealthy smoke-laden air. These conditions threaten progress toward meeting the state's long-term climate goals.

Recent wildfires have been the deadliest, most destructive, costliest, and largest in state history, and more than 129 million trees, primarily in the Sierra Nevada, have died from drought and insects since 2010. It is estimated that as many as 15 million acres of California forests need some form of restoration.

In recognition of the severe fire conditions across the state, the Administration's January Cap and Trade Expenditure Plan proposes $160 million for the Department of Forestry and Fire Protection (CAL FIRE) to support forest improvement and fire prevention projects that reduce fuel loads, decreasing the intensity of wildfires and associated greenhouse gas emissions, as well as potential impacts to watersheds and communities.

The Administration recently released the California Forest Carbon Plan, which serves as a scientific foundation and policy vision for improving the health and resiliency of California's forests against the worsening threats of fire and disease driven by climate change. The Governor issued an executive order to call for an expansion of forest restoration and management activities in alignment with the Forest Carbon Plan. A Forest Management Task Force will also be convened to coordinate these efforts. The May Revision proposes $96 million to implement the key recommendations of the Forest Carbon Plan.

Significant Adjustments:

- Prescribed Fire and Fuel Reduction—An increase of $26.8 million Greenhouse Gas Reduction Fund and 79 positions for CAL FIRE to complete additional fuel reduction projects through the operation of six year-round prescribed fire crews and implementation of a forest health research and monitoring program. This funding supports the Forest Carbon Plan's recommendation to increase the rate of prescribed fire and fuel reduction, allowing CAL FIRE to treat 60,000 acres per year.
- Sierra Regional Forest Health Projects—An increase of $30 million California Drought, Water, Parks, Climate, Coastal Protection and Outdoor Access for All Fund (Proposition 68), assuming voter approval in June 2018, for the Sierra Nevada Conservancy to expand the Watershed Improvement Program and fund Forest Carbon Plan recommended activities. This Program, guided by a Memorandum of Understanding between the Natural Resources Agency and the U.S. Forest Service, supports regional, landscape-level forest restoration projects in collaboration with federal and local agencies.
- Northern, Coastal and Southern California Regional Forest Health Projects—An increase of $20 million Greenhouse Gas Reduction Fund for the Natural Resources Agency to provide block grants to support regional implementation of landscape-level forest restoration projects that leverage non-state funding. This proposal will build on the success of the Sierra Nevada Conservancy's Watershed Improvement Program by expanding the program model to the Northern, Coastal and Southern California regions.
- Legacy Forests at State Parks—An increase of $15 million Proposition 68 for the Department of Parks and Recreation to protect forests in state parks. This funding will support restoration efforts in state parks throughout the state, including coastal redwoods, central Sierra sequoias, coastal pines, and oak woodlands.
- Watershed Coordinator Grants—An increase of $1.9 million Environmental License Plate Fund for the Department of Conservation to provide grants to local entities to develop and implement watershed improvement plans.
- Markets for Wood Products—An increase of $2.3 million Timber Regulation and Forest Restoration Fund for multiple programs that will encourage markets for wood products, including (1) establishment of a Joint Institute for Wood Products Innovation, (2) financial support for mass timber and wood product manufacturing, and (3) grants for local jurisdictions to showcase the architectural design of mass timber buildings.

## Biodiversity Preservation

California has some of the world's most unique geographical areas that support plant and wildlife biodiversity. It is home to more species of plants and animals than any other state in the U.S., which creates a complex and distinctive ecosystem.

The Administration is implementing a California Biodiversity Initiative to improve understanding of the state's biological richness and to preserve, manage and restore the ecosystems to protect that state's biodiversity from climate change. The Initiative will include partnerships with Tribes, educators and researchers, philanthropy, the private sector, and landowners to preserve California's biodiversity.

## Flood Control Infrastructure

The Central Valley Flood Protection Plan identified $17 billion to $21 billion in flood system investment needs over the next 30 years, including urban and non-urban projects, systemwide projects, operations and maintenance, and deferred maintenance. Of the total need, the Plan identifies approximately $88 million needed annually for operations and maintenance.

Over the past decade, voters have approved several General Obligation bonds that have provided approximately $5 billion in flood control improvements. Of this amount, there is approximately $284 million in remaining Proposition 1 funds available for flood investments. In addition, Proposition 68, on the June ballot, includes an additional $550 million for flood control programs. However, these remaining bond funds are largely limited to multi-benefit projects that provide fish and wildlife enhancements, or improvements to levee projects located in the Delta. While these bond funds will support systemwide projects identified in the Central Valley Flood Protection Plan, most urban projects, operations and maintenance, and deferred maintenance needs are not eligible for existing bond funding.

In recognition of the impacts of climate change and the likelihood of more severe storms and extreme weather events in the coming decades, the May Revision proposes an additional $295 million General Fund to enhance the state's resilience to catastrophic flooding. This proposal provides strategic investments for flood control infrastructure to protect lives and property that also leverage local and federal funding and reduce potential state liability.

Significant Adjustments:

- Urban Flood Control Projects—An increase of $170 million General Fund on a one-time basis to support the state cost-share of U.S. Army Corps of Engineers' urban flood control projects that will contribute to a 200-year level of flood protection in urban areas of the Central Valley. This funding will strengthen the state's ability to leverage approximately $690 million in federal funding.
- Deferred Maintenance—An increase of $100 million General Fund on a one-time basis to address deferred maintenance projects on levees, as referenced in the Statewide Issues and Various Departments Chapter. These funds will be prioritized to address identified critical and serious sites, including repair and rehabilitation of damaged levees and infrastructure as a result of the 2017 storms.
- Operations and Maintenance—An increase of $25 million General Fund to support ongoing levee maintenance. These funds will provide incentives for cost-sharing with local maintaining agencies by (1) encouraging a regional governance model that will better allow local entities to assess local beneficiaries of the levee system and (2) updating assurance agreements with the state to clarify levee maintenance responsibilities. Funds will also be available for priority projects that reduce potential state liability.

## Protecting and Preserving Native American Heritage

Over the past several years, the Administration has strengthened the state's relationship with California's tribal communities by improving overall communication and enhancing transparency and government-to-government engagement with California Tribes. The Governor's Executive Order B-10-11 established the Office of the Tribal Advisor to provide a direct link between Tribes and state agencies, allowing Tribes to actively participate in developing policies and priorities for tribal communities in partnership with the highest levels of state government.

The May Revision builds on these efforts with additional state investments that will protect, preserve and celebrate the rich history of the tribal peoples of California and memorialize their important contributions to the state.

Significant Adjustments:

- California Indian Heritage Center—An increase of $100 million General Fund for the Department of Parks and Recreation to construct a new museum to protect, preserve and celebrate the history of California's tribal peoples. The total cost of the project is estimated at $200 million. The Administration will work with interested parties to raise the additional $100 million necessary to complete the project. This new museum will replace the current State Indian Museum, which was built in 1940 on the grounds of Sutter's Fort State Historic Park. The Department will operate the museum and work with tribal representatives in developing appropriate content for the interpretive program.

- Fort Ross State Historic Park: Cultural Trail—An increase of $852,000 Proposition 12 bond funds to design a new trail focusing on increasing the interpretive program at Fort Ross State Historic Park. The trail would complete a segment of the California Coastal Trail and a multimedia interpretive program encouraging park visitors to explore the complex history of the site. The interpretive program will be developed through a partnership with stakeholders including the tribal people of the area and UC Berkeley. Total project costs are estimated to be $3.4 million.

In addition, the Administration proposes $643,000 General Fund and ten positions to expand the Native American Heritage Commission to better fulfill its mission of protecting Native American graves, sacred sites and tribal cultural resources.

## Museum of Tolerance

Located in Los Angeles, the Museum of Tolerance is the educational branch of the Simon Wiesenthal Center. The Museum is dedicated to educating visitors about the Holocaust in both historic and contemporary contexts and providing a voice for social justice and human rights in the world today. The Museum has welcomed over 7 million visitors since it opened in 1993, and more than 160,000 law enforcement professionals have participated in a diversity training program to enhance their skills in delivering more effective services to the communities they serve. In addition, 130,000 middle and high school students visit the Museum each year as part of their schools' curriculum. The Museum provides a unique immersive learning environment to advance anti-bias education and promote the creation of inclusive and equitable schools.

Significant Adjustment:

- Museum of Tolerance Renovation Project—An increase of $10 million General Fund on a one-time basis for the Department of Parks and Recreation to provide a grant for the Museum's renovation project. This funding will provide half of the estimated $20 million cost of the renovation to fund critical capital improvements.

# Statewide Issues and Various Departments

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

## Housing and Homelessness

California has 25 percent of the nation's homeless population. According to 2017 data from the U.S. Department of Housing and Urban Development (HUD), California's homeless population has risen to nearly 135,000 individuals, up 13.7 percent since 2016. Of this number, more than 91,000 are considered unsheltered—meaning their primary nighttime location was a public or private space not ordinarily used for sleeping, such as a vehicle, park, or street. The majority of individuals experiencing homelessness belong to vulnerable populations including those with severe mental illness (34,673), victims of domestic violence (32,217), individuals with chronic substance use disorders (24,500), and unaccompanied youth (15,458).

Homelessness is fundamentally a local government responsibility, with cities responsible for the zoning and siting for housing and counties responsible for the provision of health and social services. Local jurisdictions are best positioned to address homelessness and identify solutions to meet local needs. Addressing homelessness requires collaboration between cities and counties to provide facilities and wraparound services. Many local jurisdictions have taken steps to mitigate homelessness but efforts to address identified problems have often been hindered by resistance to permitting and financing housing for this population. Over the years, the state has provided supplemental funding and a number of policy solutions to address homelessness—including the establishment of Enhanced Infrastructure Financing Districts and Community Revitalization and Investment Authorities, which utilize property taxes and other available funds for affordable housing projects, California Environmental Quality Act (CEQA) streamlining, and planning and zoning density bonuses.

More recently, the state has made sizeable investments to tackle the state's growing homelessness problem. Notably, on July 1, 2016, Governor Brown signed legislation enacting the No Place Like Home program, which dedicates $2 billion in bond proceeds to invest in the development of permanent supportive housing for persons who are in need of mental health services and are experiencing homelessness, chronic homelessness, or who are at risk of chronic homelessness. The bonds are to be repaid by funding from the Mental Health Services Act. The issuance of the bonds, however, has been delayed by legal challenges to the program.

The May Revision proposes placing the No Place Like Home program on the November 2018 ballot, allowing voters to validate the bonds, rather than waiting for validation through the courts. In anticipation of voter approval, the May Revision includes a $1.2 million General Fund loan to the Department of Housing and Community Development to issue an initial Notice of Funding Availability prior to November and make awards before the end of the calendar year.

The 2017 Budget Act included a housing package with various long-term statutory solutions that collectively shorten the housing development approval process, promote local accountability to adequately plan for needed housing, and invest in affordable housing production through dedicated real estate transaction fee revenues, as well as a $4 billion housing bond that will be on the November 2018 ballot.

The Governor's Budget included $4.4 billion in state and federal funding across various departments and programs to develop affordable housing, provide assistance to first-time homebuyers, and offer various supports for individuals experiencing homelessness.

Many of these policy changes and construction investments will take time to result in additional units.

In recognition of the longer time frame existing investments and policies may take to implement, the May Revision includes targeted local dollars to provide assistance to local governments in tackling homelessness. These largely one-time investments will serve as a funding bridge to continue and/or initiate local efforts until additional, significant dollars are available or programs are implemented—in particular, the housing bond and revenues from the real estate transaction fees.

The May Revision proposes $359 million one-time and $64 million General Fund ongoing (see Figure SWE-01) to focus state homelessness funding on planning, prevention, and emergency aid.

Figure SWE-01
**Homelessness Response Proposal**
(Dollars in Millions)

| Department | Program | 2018-19 | Ongoing |
|---|---|---|---|
| Homeless Coordinating and Financing Council[1/] | Emergency Homeless Aid Block Grants | $250.0 | - |
| | Council Administration | 0.5 | 0.5 |
| Department of Social Services | CalWORKs Housing Support Program | 24.2 | 48.3 |
| | CalWORKs Homeless Assistance Program | 8.1 | 15.3 |
| | Senior Home Safe Program | 15.0 | - |
| Office of Emergency Services | Domestic Violence Shelters and Services | 10.0 | - |
| | Homeless Youth and Exploitation Program | 1.0 | - |
| Department of Health Care Services | Homeless and Mental Illness Program | 50.0 | - |
| **Total** | | **$358.8** | **$64.1** |

[1/] Housed within the Business, Consumer Services, and Housing Agency.

## Planning

Given the many state resources that will be available in the coming years, the May Revision proposes $500,000 and three positions to expand the Homeless Coordinating and Financing Council established by Chapter 847, Statutes of 2016 (SB 1380), and move it to the Business, Consumer Services, and Housing Agency. The Council will provide statewide guidance on homelessness issues and develop a statewide plan, in collaboration with state and local entities, to support the coordination of the various housing and homelessness investments throughout the state. Additionally, the Council will work in collaboration with other stakeholders to evaluate grant proposals for a $250 million General Fund homelessness emergency aid block grant described in more detail below.

## Prevention

The May Revision proposes $47.3 million in 2018-19 and $63.6 million ongoing to support safety net programs operated by the Department of Social Services to prevent vulnerable Californians from becoming homeless or help them obtain housing, as referenced in the Health and Human Services Chapter:

- Establish a senior homelessness prevention pilot program with $15 million in one-time funding over three years, and require participating counties to match funds received.

- Expand the existing $47 million CalWORKs housing support program with an increase of $24.2 million in 2018-19. With an additional increase in 2019-20, the program will reach $95 million ongoing to provide assistance to low-income families obtaining and maintaining permanent housing.
- Increase funding for the CalWORKs Homelessness Assistance program by $8.1 million in 2018-19 and $15.3 million ongoing to raise the payment from $65 per day to $85 per day to provide families with up to 16 days of temporary shelter.

### Emergency Aid

To assist locals in addressing homelessness until more state resources are available next year, the May Revision proposes emergency assistance funds as follows:

- Create a one-time Homelessness Emergency Aid block grant of $250 million administered through Continuums of Care (federal HUD designations) for cities, counties or joint powers authorities that declare a local shelter crisis and identify city-county coordination. Grants can be used for emergency housing vouchers, rapid rehousing, emergency shelter construction, and use of armories to provide temporary shelters, among other activities.
- Provide one-time funding of $1 million through the California Office of Emergency Services to augment the Homeless Youth and Exploitation Program for homeless and exploited youth shelters that serve unaccompanied minors.
- Increase funding by $10 million through the California Office of Emergency Services for additional domestic violence service providers for projects that include emergency “safe” homes or shelters for victims and their families.
- Provide a one-time augmentation of $50 million for the Department of Health Care Services to provide counties with funding for intensive outreach, treatment and related services for homeless persons in need of mental health services, as referenced in the Health and Human Services Chapter.

## Wildfire Response and Recovery

California was faced with unprecedented and historic disasters in 2017—floods, wildfires and mudslides—leading to the loss of lives and homes. The Governor's Budget included funding of $419.1 million for various recovery, response, and preparation activities. The May Revision includes additional investments for recovery efforts and to create a stronger emergency response system in California.

## Office of Emergency Services

**Public Safety Communications**—The May Revision includes $15 million State Emergency Telephone Number Account (SETNA) to begin a five-year plan to upgrade the California Public Safety Microwave Network from an analog system to a digital system for emergency response continuity. The Network provides connectivity for public safety radio systems that link responders and dispatchers, provides redundancy and resiliency, and enhances disaster recovery and the ability to support the Next Generation 9-1-1 system proposed in the Governor's Budget. Next Generation 9-1-1 provides various benefits compared to the legacy system, including faster call delivery, increased routing accuracy and functionality, call overflow and backup functionality, updated geographic information capability and wireless location data, and incoming text capability. Combined, these proposals will improve public safety and significantly advance California's emergency response capabilities.

**Immediate Aid to Restart School Operations**—$14.4 million Federal Trust Fund to provide assistance or services to local educational agencies, including charter schools and private schools to help defray expenses related to the restart of operations, reopening, and reenrolling students in elementary and secondary schools, that serve an area affected by a covered disaster or emergency.

**Recovery Program Workload**—$2.8 million General Fund and $8.4 million Federal Trust Fund to address increased workload related to disaster recovery activities, including working with impacted communities to implement and administer the California Disaster Assistance Act (CDAA) and federal disaster programs.

**Disaster Service Worker Volunteer Program**—$675,000 General Fund to provide sufficient and timely workers' compensation benefits to injured volunteers and eligible survivors, and to issue medical provider payments without incurring penalty and interest fees.

**Emergency Response Operations**—$1.6 million General Fund to increase staffing within the Office of Emergency Services' Homeland Security Branch and Regional Response and Readiness Branch. These branches support liaison efforts between federal, state, and local partners, and assist with responding to disasters and emergency management coordination.

**Situational Awareness and Collaboration Tool**—$353,000 General Fund and $325,000 reimbursements for the Office of Emergency Services to manage and train local agencies on the effective use of this tactical tool, which is deployed in the field to coordinate various disaster response efforts, including, but not limited to, evacuations, warnings, and shelters.

**Hazard Mitigation Program**—$3.2 million Federal Trust Fund to handle the increased workload in hazard mitigation activities throughout the state due to the increase in available federal fund resources. Mitigation programs provide funding for eligible activities that reduce disaster losses and protect life and property from future disaster damages.

**Regional Hazardous Materials Response Program**—$3.4 million General Fund for the Office of Emergency Services to provide regional and on-site support for planning, response, and mitigation capabilities in the event of a release of hazardous materials.

## California Department of Resources Recycling and Recovery (CalRecycle)

**CalRecycle Debris Removal Assistance Program**—$1.3 million Integrated Waste Management Fund for CalRecycle to lead a disaster response and recovery team that would become the subject matter experts for disaster recovery and debris removal. The team will respond to disaster events, train internal staff, support local agency requests for technical assistance, and assist with disaster response and debris removal plans.

## California Disaster Assistance Act

The May Revision includes a one-time augmentation of $49.5 million General Fund to increase the amount of funding available through CDAA, which is used to repair, restore, or replace public real property damaged or destroyed by a disaster, and to reimburse local government costs associated with certain emergency activities undertaken in response to a state of emergency. This augmentation increases total CDAA funding to $121.7 million in 2018-19.

## Disaster Response Emergency Operations Account

As of the May Revision, the Director of Finance had accessed $375.8 million in resources available in the State Fund for Economic Uncertainties for various departments related to unexpected equipment, personnel, and other disaster assistance costs incurred under the Governor's State of Emergency Proclamations related to the wildfires. The majority of these costs are associated with the removal of hazardous waste and debris that threaten public health and the environment if not immediately addressed. Resources were also made available to the Department of Social Services for the purchase and distribution of food to individuals affected by the Northern California fires, as well as rental/mortgage vouchers and utility assistance for those who would otherwise be ineligible to receive federal assistance.

The May Revision includes statutory changes to amend Government Code section 8690.6 to clarify that allocations from the Disaster Response Emergency Operations Account may be used for activities that commence within 120 days after a proclamation of emergency by the

Governor and remove the sunset date of January 1, 2019.

### Local Property Tax Backfill and Debris Removal Cost Share Waiver

The May Revision includes $32.8 million General Fund to backfill the property tax revenue losses that cities, counties, and special districts will incur in 2017-18 and 2018-19 due to the 2017 wildfires and resulting mudslides in Southern California. Of this amount, $21.8 million is for Northern California jurisdictions and $11 million is for Southern California jurisdictions. This funding level is based on information provided by the county assessors.

The wildfire-related property tax revenue losses incurred by K-14 schools are generally backfilled under the Proposition 98 school funding mechanism. Without the backfill, the Budget estimates K-14 schools would have incurred $22.6 million in cumulative property tax revenue losses in 2017-18 and 2018-19 due to the Northern California wildfires and $14.5 million due to the Southern California disasters.

Additionally, the May Revision includes $29.1 million General Fund to waive the local match for Northern California counties' costs of debris removal.

### Federal Supplemental Appropriations Bill for 2017 Disasters

The Governor declared emergencies in all of the disasters discussed above, and secured a Presidential Major Disaster Declaration for the Northern and Southern California wildfires, and subsequent Southern California mudslides, providing direct federal aid for residents of those counties who suffered related losses. Workers in these counties who have lost jobs or had work hours substantially reduced as a result of the fires are also now eligible for federal Disaster Unemployment Assistance benefits.

In addition to investments made by California, Congress passed a supplemental disaster-related appropriations bill totaling $4.4 billion to support the state’s recovery efforts associated with these disasters. The Administration, through the Office of Emergency Services, is working closely with local officials to provide technical assistance and guidance to enable local governments to access these funds to support local recovery efforts that will boost the economy as well as reinstate essential services.

## Medicinal and Adult-Use Cannabis

The Medical Marijuana Regulation and Safety Act enacted in 2015 created a regulatory framework for medical cannabis in California, and distributed the responsibility for state licensing between three state entities—the Department of Food and Agriculture, the

Department of Public Health, and the Bureau of Cannabis Control. In November 2016, voters approved Proposition 64, the Adult Use of Marijuana Act, which legalized the recreational sale and use of cannabis to people over the age of 21. In addition, Proposition 64 levied new excise taxes on the cultivation and retail sale of both adult use and medical cannabis. Chapter 27, Statutes of 2017 (SB 94), integrated medical and adult use regulations to create the Medicinal and Adult-Use Cannabis Regulation and Safety Act (Cannabis Act), which established the overall regulatory framework of medicinal and adult-use cannabis in California.

As approved in Proposition 64, new excise taxes will be levied on the cultivation and retail sale of both recreational and medical cannabis with tax revenues being deposited into the Cannabis Tax Fund. The cannabis excise taxes are forecast to generate $185 million in 2017-18 and $630 million in 2018-19. The first quarterly deposit was due on April 30, 2018, and based on tax returns received through May 2, 2018, $33.6 million in excise tax has been reported. While the forecast assumes revenues will be phased in over time, preliminary data indicates revenue receipts are slower than anticipated.  Cannabis revenue projections are subject to great uncertainty.

Proposition 64 specified the allocation of resources in the Cannabis Tax Fund, which are not subject to appropriation by the Legislature. Pursuant to Proposition 64, expenditures are prioritized as follows:

- Regulatory and administrative costs necessary to implement, administer, and enforce Proposition 64. The Administration will use initial revenues to repay General Fund loans totaling $120 million to support these activities while cannabis tax proceeds were unavailable.
- Research and activities related to the legalization of cannabis, and the past effects of its criminalization.
- Programs to support substance use disorder treatment, environmental impacts of cannabis cultivation, and public safety. Because the tax proceeds dedicated to these programs are based on prior year actual tax collection, the May Revision assumes that initial funding for these programs will be available in 2019-20, consistent with Proposition 64. Potentially lower tax proceeds noted above would impact the amount available for these programs in 2019-20.

The May Revision includes an additional $133.3 million for cannabis-related activities, including the processing of licenses and permits, enforcement, laboratory services, information technology, quality assurance, and environmental protection. The proposals are funded by the Cannabis Tax Fund and the Cannabis Control Fund, which receives revenue from licensing fees.

Given that the state is in the early stages of implementation, the May Revision provides funding for these programs on a two-year limited-term basis. This will provide the Administration the opportunity to evaluate the ongoing level of funding needed to support these activities.

The May Revision includes funding for the following activities:

**Licensing and Enforcement**—Continues implementation of licensing and enforcement programs for the cultivation, manufacturing, testing, distribution, and retail sale of recreational and medicinal cannabis, including support for the Cannabis Track and Trace system to report the movement of cannabis through the distribution chain, the establishment of regional offices for licensing and cash collection, resources to audit the Bureau of Cannabis Control as required by law, and a public awareness campaign of the benefits of the legalized market. Specifically, funding is authorized for the following entities: California Department of Food and Agriculture ($28.3 million), California Department of Public Health ($10.6 million), Department of Consumer Affairs ($33.9 million), and Department of Finance ($440,000). Also, the May Revision includes a General Fund loan of up to $59 million to the Cannabis Control Fund to provide sufficient cash for 2018-19.

**Tax Collection and Business Filings**—Supports ongoing tax collection activities, including collection of cash payments, information technology system enhancements, and security upgrades at state offices, as well as the Secretary of State's ability to process cannabis-related business and trademark filings. Specifically, funding is authorized for the following entities: Employment Development Department ($3.7 million), California Department of Tax and Fee Administration ($2.4 million), Franchise Tax Board ($193,000), and Secretary of State ($440,000 Business Fees Fund).

**Hearings and Appeals**—Provides funding for the Cannabis Control Appeals Panel ($1.4 million) and the Department of General Services ($13 million Service Revolving Fund) to conduct administrative hearings and appeals that result from denying, transferring, conditioning, suspending, or revoking issued licenses.

**Illegal Cannabis Market Enforcement**—Provides funding for the Department of Justice ($14 million) to establish four investigation teams and one interdiction team to investigate illegal cannabis activity with an emphasis on complex, large-scale financial and tax evasion investigations as well as reducing environmental and other crimes associated with the illegal cannabis market.

The May Revision also includes funding for the following programs, as specified in Proposition 64:

**Community Engagement**—$10 million for the Governor's Office of Business and Economic Development to support the Community Reinvestment Grants Program that will be awarded on a competitive basis to local health departments and qualified community-based non-profit organizations to support substance use disorder treatment, job placement, legal services, and other cannabis use-related programs.

**Research**—$2 million for the University of California San Diego's Center for Medicinal Cannabis Research to further the objectives of the Center, including the enhanced understanding of the efficacy and adverse effects of cannabis as a pharmacological agent; and $10 million to a public university or universities chosen by the Bureau of Cannabis Control to research and evaluate the implementation and effect of Proposition 64, and make recommendations to the Legislature and Governor regarding possible amendments to the Act.

**Drug Recognition**—$3 million for the California Highway Patrol to establish and adopt protocols to determine whether a driver is operating a vehicle while impaired, including best practices to assist law enforcement agencies.

Based on estimated revenues and pursuant to Proposition 64, the remaining programs will not receive funding until 2019-20 and funding will be based on collections received in 2018-19. Once funding is available beginning in 2019-20, Proposition 64 allocates resources for the following activities: (1) education, prevention, and treatment of substance use disorders; (2) clean-up, remediation and enforcement of environmental impacts created by cannabis cultivation; and (3) various public safety programs.

## Climate Smart Agriculture

California's agricultural sector offers substantial opportunities to reduce greenhouse gas emissions while improving air quality and maintaining our food economic security. Through Climate Smart Agriculture programs, farmers and ranchers will achieve greenhouse gas reductions and build resilience across diverse agricultural systems and landscapes.

The Administration's Cap and Trade Expenditure Plan provides $244 million for multiple Climate Smart Agriculture programs. The May Revision builds on the Cap and Trade proposal with additional one-time investments to reduce greenhouse gas emissions.

Significant Adjustments:

- Agricultural Diesel Engine Replacement and Upgrades—An increase of $30 million General Fund on a one-time basis to the Air Resources Board to replace existing diesel agricultural vehicles and equipment with the cleanest available diesel or advanced technologies. Emissions from agricultural equipment are a significant source of air pollution, especially in the San Joaquin Valley, and reducing these emissions is critical for meeting federal ozone and particulate matter air quality standards.
- Agricultural Energy Efficiency Program—An increase of $30 million General Fund on a one-time basis for the Energy Commission to fund innovative projects that reduce energy costs, increase efficiency, and reduce greenhouse gas emissions in the food processing sector. Funded technologies will accelerate the adoption of advanced energy efficiency and renewable energy technologies, and help contribute to meeting the state's energy efficiency and greenhouse gas reduction goals.

## Payment of Expired and Repealed State Mandates

The May Revision includes a one-time payment of $282.2 million General Fund plus interest to repay local agencies for costs incurred for 14 state mandates that have expired or been repealed. The repayment amount represents the retirement of state obligations to local agencies for costs incurred between 2004 and 2011. The majority of the repayment, $253.9 million plus interest, is owed as a result of mandates associated with mental health services for severely emotionally disturbed children (AB 3632), and local agencies are expected to use the repayment toward services for youth, as referenced in the Housing and Homelessness section and related issue in Health and Human Services Chapter.

## State Retirement Contributions

The May Revision includes the following adjustments for retirement contributions:

- State contributions to the California Public Employees' Retirement System (CalPERS) have decreased by $18.1 million ($12.4 million General Fund) relative to the Governor's Budget. The reduction is a result of CalPERS' adjustment to the state's contribution rates, which is mainly driven by CalPERS' higher than expected investment return in 2016-17, the benefit of the state's additional $6 billion pension payment in 2017-18, and higher than projected enrollment of members under the Public Employees' Pension Reform Act of 2013, who have lower benefit formulas.

- State contributions to the California State Teachers' Retirement System (CalSTRS) increased by $5.6 million General Fund due to a revision in reported compensation for K-12 and community college teachers.
- State contributions to the Judges' Retirement System II (JRS II) decreased by $5.3 million General Fund due to a decrease in the employer contribution rate, which is attributed to CalPERS' newly adopted demographic assumptions.

Figure SWE-02 provides a historical overview of contributions to CalPERS, CalSTRS, the Judges' Retirement System (JRS), JRS II, and the Legislators' Retirement System (LRS) for pension and health care benefits.

Figure SWE-02
**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 | Employer OPEB Prefunding[4/] |
|---|---|---|---|---|---|---|---|---|---|---|
| 2008-09 | $3,063 | | $1,133 | $189 | $40 | | $2,146 | $1,183 | | |
| 2009-10 | 2,861 | | 1,191 | 184 | 32 | | 2,120 | 1,182 | | $3 |
| 2010-11 | 3,230 | | 1,200 | 166 | 54 | | 2,277 | 1,387 | | 2 |
| 2011-12 | 3,174 | | 1,259 | 195 | 58 | | 2,439 | 1,505 | | 0 |
| 2012-13 | 2,948 [5/] | $449 [5/] | 1,303 | 160 | 51 | | 2,567 | 1,365 [5/] | $222 [5/] | 0 |
| 2013-14 | 3,269 | 474 | 1,360 | 188 | 52 | $1 | 2,697 | 1,383 | 225 | 22 |
| 2014-15 | 4,042 | 543 | 1,486 | 179 | 63 | 1 | 2,797 | 1,462 | 256 | 38 |
| 2015-16 | 4,338 | 585 | 1,935 | 190 | 67 | 1 | 2,968 | 1,556 | 263 | 63 |
| 2016-17 | 4,754 | 621 | 2,473 | 202 | 68 | 1 | 3,104 | 1,623 | 272 | 342 [7/] |
| 2017-18 | 5,188 | 661 | 2,790 | 197 | 76 | 1 | 3,252 | 1,771 | 291 | 189 |
| 2018-19[6/] | 5,506 | 683 | 3,082 | 195 | 74 | 1 | 3,435 | 1,891 | 311 | 373 |

1/ The chart does not include contributions for University of California pension or retiree health care costs, and does not reflect the $6 billion supplemental pension payment in 2017-18 authorized by Chapter 50, Statutes of 2017 (SB 84).

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 California State University (CSU).

4/ Amount reflects the employer contribution to pay down the Other Post-Employment Benefits (OPEB) unfunded liability.

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

6/ Estimated as of the 2018-19 May Revision to the Governor's Budget. 2018-19 General Fund costs are estimated to be $2,890 million for CalPERS, $683 million for CSU CalPERS, $1,613 million for Active Health and Dental, $2,198 million for Retiree Health & Dental (including CSU), and $194 million for OPEB Prefunding. The remaining totals are all General Fund.

7/ Amount includes a one-time prefunding contribution of $240 million pursuant to Chapter 2, Statutes of 2016 (AB 133).

## Employee Compensation and Collective Bargaining

The May Revision decreases employee compensation by $8.1 million to reflect corrections to 2019 health rates, natural changes to enrollment in health and dental plans, updated employment information for salary increases and other post-employment benefit contributions, revised pay increases for judges, and updated costs related to the salary survey estimates for the California Highway Patrol (Bargaining Unit 5).

Additionally, the May Revision includes costs associated with the salary and benefit increases resulting from the pending completion of contract negotiations with the California Correctional Peace Officers Association. The Administration will begin or continue collective bargaining negotiations with the three remaining bargaining units whose contracts with the state will expire in late June or early July 2018.

## Department of Human Resources

Consistent with the policy memorandum issued by the Governor's Office to state agencies and departments, the May Revision includes $1.4 million ($720,000 General Fund) for the Department of Human Resources to establish a tracking system to collect data regarding complaints, judgments, and settlements related to workplace discrimination and harassment across all state entities. A unit will be established within the Office of Civil Rights to identify and monitor trends and patterns of problematic behavior, prepare executive and legislative reports related to the data being tracked, and expand policies, procedures, and training related to preventing discrimination and harassment.

## Infrastructure Investments

The May Revision provides a $630 million General Fund transfer to the State Project Infrastructure Fund. The funding will provide for the completion of several office building projects in the Sacramento area over the next few years, including demolition of the State Printing Plant, and renovation of the Unruh, Bateson, and Resources buildings.

In addition, the May Revision allocates one-time resources of $1.21 billion—$1.06 billion General Fund, $143.5 million Proposition 98 General Fund, and $7 million Motor Vehicle Account—to address critical deferred maintenance needs. The proposed investments in deferred maintenance are as follows:

- California Community Colleges: $143.5 million (Proposition 98 General Fund)

- Department of Corrections and Rehabilitation: $174 million
- Department of Water Resources: $100 million for levee repairs
- Judicial Branch: $100 million
- Department of State Hospitals: $100 million
- California State University: $100 million
- University of California: $100 million
- Department of Parks and Recreation: $100 million
- Department of General Services: $75 million
- Department of Developmental Services-Porterville Facility: $60 million
- California Military Department: $50 million
- Department of Veterans Affairs: $50 million
- State Special Schools: $16 million
- Network of California Fairs: $10 million
- Office of Emergency Services: $8 million
- California Highway Patrol: $5 million (Motor Vehicle Account)
- Department of Food and Agriculture: $4 million
- Employment Development Department: $4 million
- Department of Forestry and Fire Protection: $4 million
- Department of Motor Vehicles: $2 million (Motor Vehicle Account)
- California Conservation Corps: $2 million
- California Science Center and Expo Park: $2 million
- Hastings College of the Law: $1 million

State agencies may use a portion of their allocation to assess their existing facilities to help the state better manage its infrastructure to be resilient to the effects of climate change in the future. The Department of General Services will be developing guidance and standards to assist agencies.

## State Appropriations Limit Calculation

Pursuant to Article XIIIB of the California Constitution, the 2018-19 limit is estimated to be $107.818 billion. The revised limit is the result of applying the growth factor of 4.03 percent. The revised 2018-19 limit is $964 million below the $108.782 billion estimated in January. This decrease is primarily due to changes in the following factors:

- Per Capita Personal Income
  - January Percentage Growth: 4.25%
  - May Revision Percentage Growth: 3.67%
- State Civilian Population
  - January Percentage Growth: 0.82%
  - May Revision Percentage Growth: 0.77%
- K-14 Average Daily Attendance
  - January Percentage Growth: -0.22%
  - May Revision Percentage Growth: -0.23%

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# Economic Outlook

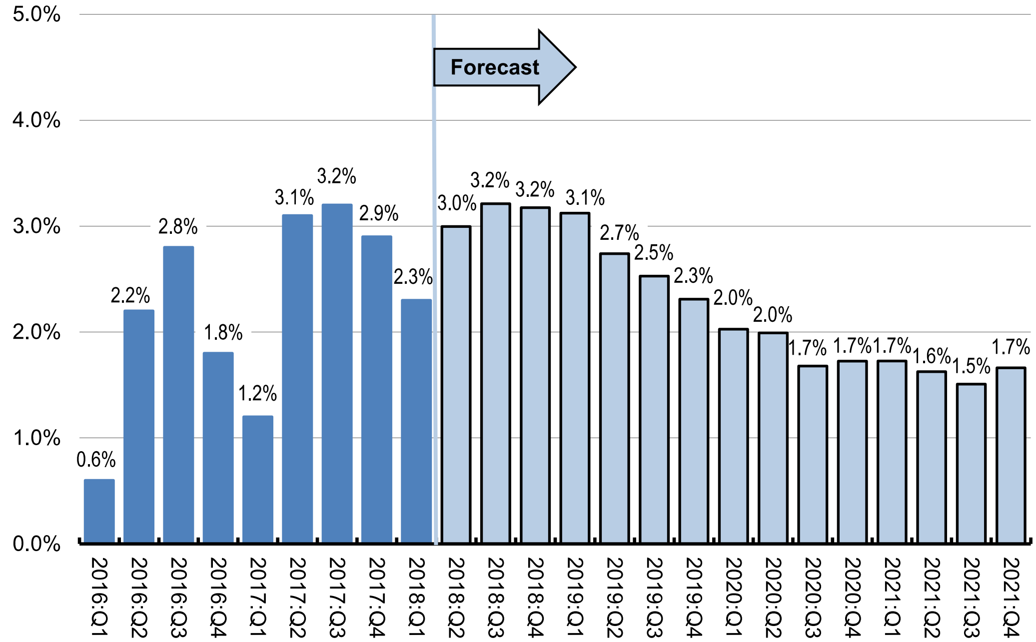
California grew to be the fifth largest economy in the world in 2017, with every sector except agriculture adding to growth. This forecast assumes that the federal tax package and the increase in federal spending will contribute to economic growth in the U.S. and California in 2018 and 2019, but will mostly benefit high-income individuals. The main risks to the outlook—a stock market correction, a recession, or global events—are the same as in January, but have increased significantly.

## The Nation – Accelerated Growth in the Short Term

The national forecast assumes higher real gross domestic product (GDP) growth in 2018 and 2019 before slowing beginning in 2020 (Figure ECO-01). The federal tax bill passed at the end of 2017 had a number of changes that affect the forecast. On the individual side, it lowered taxes for high-income households in particular, and capped the state and local tax deductions while raising the standard deduction. On the business side, it lowered the corporate tax rate from 35 percent to 21 percent while allowing businesses to write off investment expenses immediately rather than over several years. The federal spending bill passed in early 2018 also added to the temporary stimulus.

The past few years had favorable conditions for business investments. Interest rates had been near zero since 2009, and are expected to rise gradually to around 3.5 percent by 2021. The forecast assumes that federal policy will accelerate some business investment forward into 2018 and 2019, and increase the pace of automation in industries. Most of the windfall to corporations is assumed to be spent on bonuses and share purchases, not higher ongoing wages for workers.

Figure ECO-01
**U.S. Real Gross Domestic Product Quarter-to-Quarter Growth, Annualized**



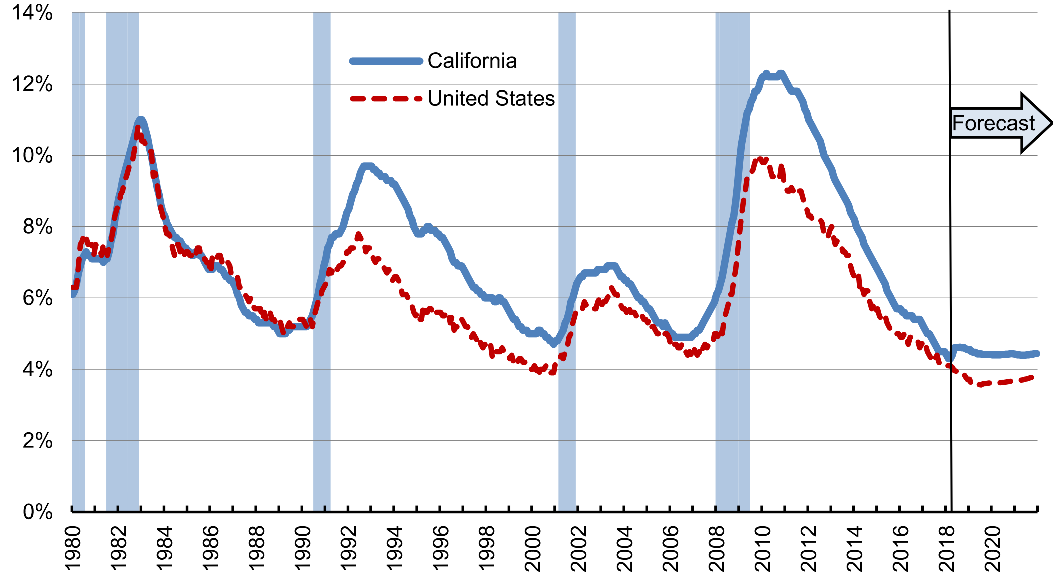

Source: U.S. Bureau of Economic Analysis; CA Department of Finance, May Revision Forecast.

The U.S. unemployment rate has been around 4 percent since October 2017. With higher employment demand from the tax cuts, and higher labor force growth through 2020, the unemployment rate for the U.S. is expected to decrease to 3.6 percent by 2019, and increase by 0.1 percentage point to 3.7 percent by 2021. U.S. inflation was 2.1 percent in 2017 and is expected to close at 2.3 percent in 2018.

## California – Uneven Growth

California's unemployment rate fell to a record low of 4.3 percent in February and March of 2018 (Figure ECO-02). In this forecast, an increase in the state's labor force participation rate will allow the unemployment rate to stay near 4.5 percent. The increase in business investment is assumed to accelerate automation in California, with job growth slowing to 1.7 percent in 2018 and decelerating throughout the forecast.

Figure ECO-02
**U.S. and California Unemployment Rate**




Shaded areas indicate U.S. recessions.
Source: U.S. Bureau of Labor Statistics; CA Employment Development Department, Labor Market Information Division; CA Department of Finance, May Revision Forecast.

Total wages and average wages by industry are expected to continue to grow throughout the forecast. However, as bonuses are counted as wages, growth is higher in 2018 and 2019. This translates into personal income growth of 5.6 percent in 2018 and 4.8 percent in 2019, before falling to around 4 percent in 2021.

Net housing units built in California were only 85,000 in 2017 due to fires that destroyed more than 13,000 units (Figure ECO-03). Job growth in the state has remained relatively concentrated in urban areas, and the forecast assumes that residential building permits will continue to increase to around 174,000 by 2021, favoring multi-family units. Although lower than the approximately 180,000 permits per year needed to keep up with population growth, the increase in permits is expected to reduce housing inflation. The statewide median sales price of an existing single-family home was around $538,000 in 2017, the highest level since 2007. California's prices are more than double the national median price of around $249,000. The median home price in California has been rising faster than median household income since 2011.

Consumer inflation has averaged 2 percent in California and 1.7 percent in the nation since 2010, as measured by the Consumer Price Index. Consumer inflation is expected to remain higher in California than the nation, with overall California inflation expected to average 3 percent in 2018 and 2019, and 2.8 percent thereafter.

Figure ECO-03

**Selected Economic Indicators**

| | 2015 | 2016 | 2017 | Forecast 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|
| **United States** | | | | | | | |
| Nominal gross domestic product, $ billions | $ 18,121 | $ 18,624 | $ 19,391 | $ 20,324 | $ 21,436 | $ 22,479 | $ 23,451 |
| Real gross domestic product, percent change | 2.9% | 1.5% | 2.3% | 2.7% | 2.9% | 2.1% | 1.7% |
| *Contributions to real GDP growth* | | | | | | | |
| Personal consumption expenditures | 2.5% | 1.9% | 1.9% | 1.8% | 1.8% | 1.7% | 1.4% |
| Gross private domestic investment | 0.9% | -0.3% | 0.5% | 1.1% | 1.0% | 0.6% | 0.4% |
| Net exports | -0.7% | -0.2% | -0.2% | -0.4% | -0.3% | -0.3% | -0.1% |
| Government purchases of goods and services | 0.3% | 0.1% | 0.0% | 0.3% | 0.3% | 0.1% | 0.0% |
| Personal income, $ billions | $ 15,553 | $ 15,929 | $ 16,427 | $ 17,159 | $ 18,082 | $ 19,003 | $ 19,907 |
| Corporate profits, percent change | -1.1% | -2.1% | 4.4% | 2.7% | 6.2% | 3.2% | 2.5% |
| Housing permits, thousands | 1,183 | 1,207 | 1,264 | -- | -- | -- | -- |
| Housing starts, thousands | 1,107 | 1,177 | 1,208 | 1,313 | 1,374 | 1,391 | 1,406 |
| Median sales price of existing homes | $ 223,900 | $ 235,500 | $ 248,800 | -- | -- | -- | -- |
| Federal funds rate, percent | 0.1% | 0.4% | 1.0% | 1.8% | 2.8% | 3.3% | 3.4% |
| Consumer price index, percent change | 0.1% | 1.3% | 2.1% | 2.3% | 2.1% | 2.3% | 2.2% |
| Unemployment rate, percent | 5.3% | 4.9% | 4.4% | 3.9% | 3.6% | 3.6% | 3.7% |
| Civilian labor force, millions | 157.1 | 159.2 | 160.3 | 162.2 | 164.2 | 166.0 | 166.9 |
| Nonfarm employment, millions | 141.8 | 144.3 | 146.6 | 149.1 | 151.7 | 153.3 | 154.0 |
| **California** | | | | | | | |
| Personal income, $ billions | $ 2,134 | $ 2,213 | $ 2,304 | $ 2,433 | $ 2,550 | $ 2,658 | $ 2,765 |
| California exports, percent change | -4.9% | -1.1% | 5.1% | -- | -- | -- | -- |
| Housing permits, thousands | 98 | 101 | 113 | 130 | 145 | 160 | 174 |
| Housing unit net change, thousands | 68 | 89 | 85 | -- | -- | -- | -- |
| Median sales price of existing homes | $ 476,320 | $ 502,930 | $ 537,860 | -- | -- | -- | -- |
| Consumer price index, percent change | 1.5% | 2.3% | 2.9% | 3.1% | 2.8% | 2.8% | 2.8% |
| Unemployment rate, percent | 6.2% | 5.5% | 4.8% | 4.6% | 4.4% | 4.4% | 4.4% |
| Civilian labor force, millions | 18.9 | 19.1 | 19.3 | 19.5 | 19.7 | 19.8 | 20.0 |
| Nonfarm employment, millions | 16.1 | 16.5 | 16.8 | 17.1 | 17.3 | 17.6 | 17.8 |
| *Percent of total nonfarm employment* | | | | | | | |
| Mining and logging | 0.2% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% |
| Construction | 4.6% | 4.7% | 4.8% | 5.1% | 5.6% | 6.1% | 6.5% |
| Manufacturing | 8.1% | 8.0% | 7.8% | 7.7% | 7.6% | 7.5% | 7.4% |
| High technology | 2.2% | 2.1% | 2.1% | 2.0% | 2.0% | 2.0% | 2.0% |
| Trade, transportation, and utilities | 18.3% | 18.1% | 18.1% | 17.9% | 17.7% | 17.6% | 17.4% |
| Information | 3.0% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% | 3.2% |
| Financial activities | 5.0% | 5.0% | 4.9% | 4.9% | 4.9% | 4.8% | 4.8% |
| Professional and business services | 15.5% | 15.3% | 15.2% | 15.1% | 14.9% | 14.9% | 14.8% |
| High technology | 2.6% | 2.6% | 2.6% | 2.6% | 2.6% | 2.6% | 2.5% |
| Educational and health services | 15.3% | 15.4% | 15.7% | 15.8% | 15.8% | 15.7% | 15.7% |
| Leisure and hospitality | 11.4% | 11.5% | 11.6% | 11.7% | 11.6% | 11.6% | 11.5% |
| Other services | 3.4% | 3.4% | 3.4% | 3.4% | 3.3% | 3.3% | 3.3% |
| Government | 15.3% | 15.3% | 15.2% | 15.2% | 15.2% | 15.2% | 15.1% |

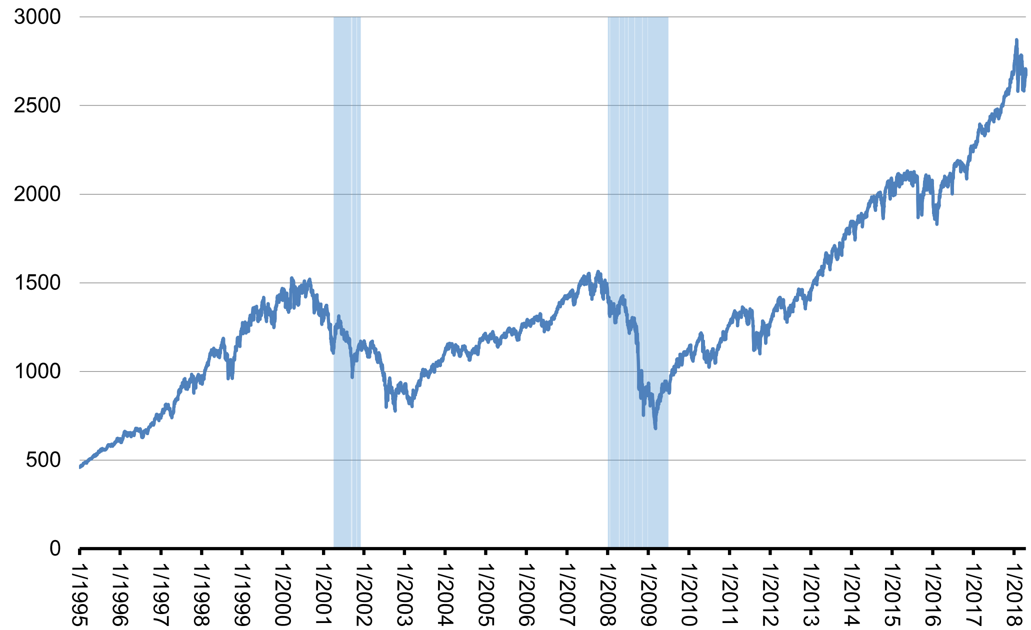
*Forecast based on data available as of April 2018.*
*Percent changes calculated from unrounded data.*

## Risks to the Outlook Have Heightened

The main risks to the California economic outlook have intensified, including a stock market correction, an eventual U.S. recession, and geopolitical risks that affect U.S. growth.

The Standard & Poor's 500 index closed to a record high of 2,873 on January 26, 2018. Despite volatility since then, the index remains high as corporations use their additional cash on share buybacks (Figure ECO-04). In the 2007-2009 economic downturn, the S&P 500 index decreased by more than 50 percent. Much of the increase since then has been due to technology companies headquartered in California, and a sudden correction would hit the state particularly hard.

Figure ECO-04
**S&P 500 Index**




Shaded areas indicate U.S. recession.
Source: S&P Dow Jones Indices.

The risk of a U.S. recession also remains. More than eight years after the end of the last recession, both the U.S. and California are at or near record unemployment rate lows. However, many households still have not recovered fully from the last recession, making it more difficult for them to weather a recession. Interest rates are only expected to rise gradually. Even under continued growth, the federal deficit is expected to exceed $1 trillion per year, and debt to GDP levels are increasing. In the next recession, the deficit could rise much higher and force cuts to federal programs on which Californians depend.

The risk of a geopolitical dispute continues, particularly in international trade. In 2017, the state's imports totaled $440 billion, of which $159 billion (36 percent) came from China. Many California companies have built globalized businesses that depend on international trade. An increase in import tariffs would have a negative effect on investment and employment throughout the state.

# Revenue Estimates

Overall, the May Revision forecast for 2016-17 through 2018-19 revenues has increased by $8 billion before accounting for transfers. There are three factors that largely contribute to this increase over the forecast window:

- Personal income tax revenues are revised upwards almost $4.4 billion due to the strong stock market at the end of 2017, higher wages, and stronger concentration of wage income among higher-income taxpayers. Although the stock market is forecast to be flat over the foreseeable future, the end-of-2017 stock market rally increases capital gains throughout the forecast.
- Sales tax receipts are up by $744 million due to an acceleration in investment by businesses as well as an increase in consumption. The increase in investment is tied to the recently adopted federal tax law.
- Corporation tax revenues are up over $2.5 billion based on corporate tax receipts received through April, including higher-than-expected audit-related payments, revenues from repatriation of foreign earnings associated with the federal tax changes, and an improved outlook for corporate profits.

After accounting for transfers, which includes loan repayments as well as automatic and discretionary transfers to the Rainy Day Fund, General Fund revenues at the May Revision forecast are higher than the Governor's Budget by almost $2.6 billion in 2017-18 and over $3.7 billion in 2018-19.

Figure REV-01 compares the revenue forecasts by source in the Governor's Budget to the May Revision. Total May Revision revenues, including transfers, is projected to be $129.8 billion in 2017-18 and $133.5 billion in 2018-19.

Figure REV-01
**2018-19 May Revision**
**General Fund Revenue Forecast**
(Dollars in Millions)

| Source | Governor's Budget | May Revision | Change From Governor's Budget Forecast | |
|---|---|---|---|---|
| **Fiscal 16-17** | | | | |
| Personal Income Tax | $82,857 | $83,264 | $407 | 0.5% |
| Sales & Use Tax | 24,872 | 24,874 | 1 | 0.0% |
| Corporation Tax | 10,116 | 11,020 | 903 | 8.9% |
| Insurance Tax | 2,422 | 2,422 | 0 | 0.0% |
| Alcoholic Beverage Tax | 368 | 368 | 0 | 0.0% |
| Cigarette Tax | 80 | 80 | 0 | 0.0% |
| Pooled Money Interest | 89 | 89 | 0 | 0.0% |
| Other Revenues | 1,304 | 1,304 | 0 | 0.0% |
| **Subtotal** | $122,110 | $123,422 | $1,312 | |
| Transfers [1/] | -3,441 | -3,441 | 0 | 0.0% |
| **Total** | **$118,669** | **$119,982** | **$1,313** | 1.1% |
| **Fiscal 17-18** | | | | |
| Personal Income Tax | $89,403 | $91,971 | $2,568 | 2.9% |
| Sales & Use Tax | 25,165 | 25,384 | 219 | 0.9% |
| Corporation Tax | 10,656 | 11,246 | 590 | 5.5% |
| Insurance Tax | 2,438 | 2,514 | 76 | 3.1% |
| Alcoholic Beverage Tax | 376 | 371 | -5 | -1.4% |
| Cigarette Tax | 65 | 67 | 2 | 2.5% |
| Pooled Money Interest | 185 | 203 | 19 | 10.2% |
| Other Revenues | 1,002 | 1,071 | 69 | 6.9% |
| **Subtotal** | $129,289 | $132,827 | $3,537 | |
| Transfers [1/] | -2,038 | -3,002 | -964 | 47.3% |
| **Total** | **$127,252** | **$129,825** | **$2,573** | 2.0% |
| **Fiscal 18-19** | | | | |
| Personal Income Tax | $93,593 | $95,009 | $1,416 | 1.5% |
| Sales & Use Tax | 26,151 | 26,674 | 523 | 2.0% |
| Corporation Tax | 11,224 | 12,248 | 1,024 | 9.1% |
| Insurance Tax | 2,508 | 2,576 | 68 | 2.7% |
| Alcoholic Beverage Tax | 382 | 377 | -5 | -1.2% |
| Cigarette Tax | 63 | 65 | 2 | 2.5% |
| Pooled Money Interest | 294 | 374 | 80 | 27.2% |
| Other Revenues | 908 | 994 | 86 | 9.4% |
| **Subtotal** | $135,123 | $138,317 | $3,194 | |
| Transfers [1/] | -5,331 | -4,804 | 527 | -9.9% |
| **Total** | **$129,791** | **$133,513** | **$3,722** | 2.9% |
| **Three-Year Total** | | | **$7,608** | |

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

## Long-Term Forecast

The May Revision economic forecast reflects improved U.S. real gross domestic product growth of close to 3 percent in 2018 and 2019. The projected average growth rate starting in 2020 then falls to 1.9 percent. While the forecast does not project a recession, the risks to the outlook are now higher, as discussed in the Economic Outlook Chapter.

Figure REV-02 shows the forecast for the largest three sources of General Fund revenues from 2016-17 through 2021-22. Total General Fund revenues from these sources is expected to grow from $119.2 billion in 2016-17 to $145.9 billion in 2021-22. The average year-over-year growth rate over this period is 4.1 percent.

Figure REV-02

**Long-Term Revenue Forecast — Three Largest Sources**

(General Fund Revenue — Dollars in Billions)

| | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | Average Year-Over-Year Growth |
|---|---|---|---|---|---|---|---|
| Personal Income Tax | $83.3 | $92.0 | $95.0 | $98.1 | $100.1 | $102.5 | 4.2% |
| Sales and Use Tax | $24.9 | $25.4 | $26.7 | $28.0 | $28.8 | $29.6 | 3.5% |
| Corporation Tax | $11.0 | $11.2 | $12.2 | $12.8 | $13.3 | $13.8 | 4.6% |
| Total | **$119.2** | **$128.6** | **$133.9** | **$138.9** | **$142.3** | **$145.9** | 4.1% |
| Growth | 4.5% | 7.9% | 4.1% | 3.7% | 2.4% | 2.6% | |

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. The 2017 Budget expanded the credit to include self-employed workers and expanded the income range so more individuals working up to full-time at the newly increased minimum wage will still qualify. About $350 million in Earned Income Tax Credit is expected to be granted to 1.5 million households this year. The May Revision includes a proposal to expand the credit to working individuals who are aged 18 to 24 or over age 65. In addition, the income range is proposed to be expanded so that more employees working up to full-time at the 2019 minimum wage of $12 per hour would qualify for the credit. This expansion of the credit is expected to cost about $60 million in 2018-19 and to benefit over 700,000 households.

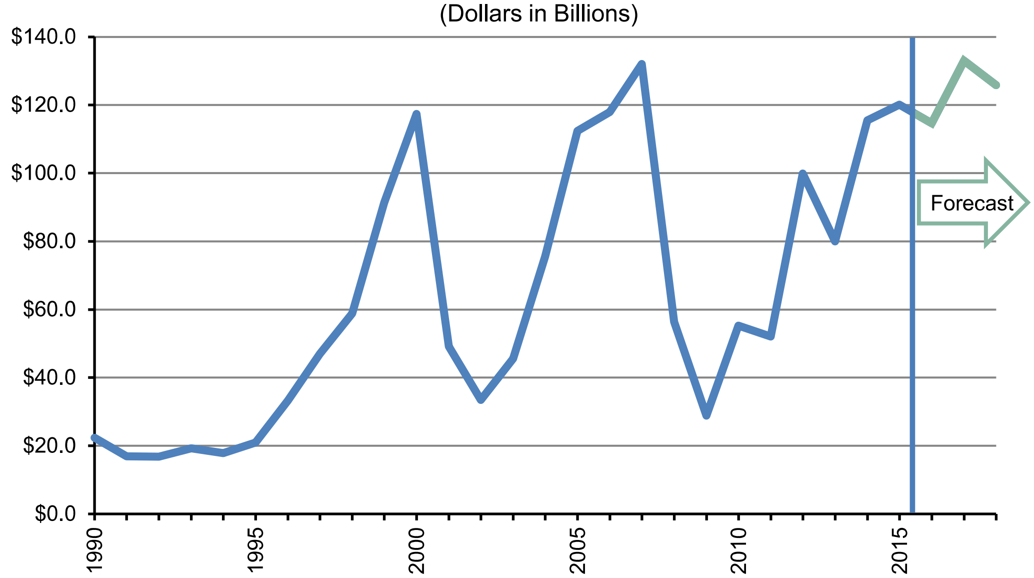
## Personal Income Tax

Compared to the Governor's Budget forecast, the personal income tax forecast is higher by $407 million in 2016-17, $2.6 billion in 2017-18, and $1.4 billion in 2018-19. Over the three-year period, the personal income tax forecast reflects a total increase of $4.4 billion.

Despite stock market volatility early in 2018, stock market values are still above the Governor's Budget assumptions, leading to a further increase in the capital gains forecast from $129 billion to $135 billion in 2017 and $133 billion to $140 billion in 2018 (see Figure REV-03). Capital gains for 2016 were revised higher from $107 billion to $113 billion, based on new Franchise Tax Board taxpayer data for 2016. Capital gains are forecast to return to a normal level of 4.5 percent of personal income by 2021, unchanged from the Governor's Budget.

Forecasting revenues associated with capital gains is subject to significant uncertainty because realizations are heavily dependent upon stock market performance and when taxpayers choose to buy or sell stock. This forecast assumes the S&P 500 will end 2018 at 2,670 and then be flat for the following years.

Figure REV-03
**Volatile Capital Gains on the Rise**
(Dollars in Billions)




Higher wage income, business income, and a concentration of wage growth among higher-income taxpayers also increased the personal income tax forecast. Withholding growth has been strong through April and has been outpacing economic wage growth, suggesting that a higher proportion of taxable wages has been going to higher-income earners who pay higher tax rates. The strong growth in 2018 withholding is expected to moderate for the remainder of calendar year 2018, as a portion of the growth seen so far is likely due to one-time bonus payments as a result of the federal tax law changes.

The personal income tax forecast includes Propositions 30 and 55 revenues, which are estimated at $7.9 billion in 2017-18 and $8.1 billion in 2018-19. These estimates are higher than the Governor's Budget by $105 million and $199 million, respectively. These are higher due to the factors discussed above.

The highest-income Californians pay a large share of the state's personal income tax. For the 2016 tax year, the top one percent of income earners paid nearly 46 percent of personal income taxes. This percentage has been greater than 40 percent for 12 of the last 13 years. The top 0.1 percent of income earners—approximately 15,000 taxpayers—paid around a quarter of personal income taxes—$18 billion.

## Sales and Use Tax

The sales tax forecast is higher by $219 million in 2017-18, and $523 million in 2018-19, primarily due to stronger growth in capital investment as a result of the federal tax law changes. Taxable sales are forecast to grow at 5.8 percent in 2017-18 and 5.6 percent in 2018-19, which are over a percentage point above the Governor's Budget.  Along with higher business investment in 2018 and 2019, the sales tax forecast for cannabis has also been revised higher, although there is considerable uncertainty associated with this industry.

## Corporation Tax

The corporation tax forecast is higher by $903 million in 2016-17, $590 million in 2017-18, and $1 billion in 2018-19. Payments related to the 2017 tax year were higher than forecast at the Governor's Budget, leading to an upward revision in the forecast for corporate profits. In addition, unusually large audit-related payments and lower refunds accrue to the prior year and increase 2016-17 revenues. The corporation tax forecast was increased by $50 million in 2017-18 and $150 million in 2018-19 due to the expected repatriation of overseas profits as a result of the federal tax law changes. The revenue impact of the financing structure for managed care organizations is unchanged from the Governor's Budget.

## Insurance Tax

The insurance tax forecast is higher by $76 million in 2017-18 and $68 million in 2018-19 due to moderately higher cash receipts. The revenue impact of the financing structure for managed care organizations is unchanged from the Governor's Budget.

## Loan Repayments to Special Funds

The May Revision reflects the repayment of loans to special funds based on the operational needs of the programs requiring these repayments. Total repayments are projected to be $128 million and $186 million in 2017-18 and 2018-19, respectively.

## Property Tax

The property tax is a local revenue source; however, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools generally offset General Fund expenditures.

Preliminary data shows statewide property tax revenues increased 5.7 percent in 2017-18, which is slightly lower than the 5.9-percent growth rate anticipated at the Governor's Budget. Property tax revenues are expected to grow 5.6 percent in 2018-19. Approximately 42 percent ($29.3 billion) of 2018-19 property tax revenues will go to K-14 schools. While this amount includes $1.6 billion that schools are expected to receive in 2018-19 due to the dissolution of redevelopment agencies, it excludes the $8.5 billion shifted from schools to cities and counties to replace Vehicle License Fee (VLF) revenue losses stemming from the reduced VLF rate of 0.65 percent.

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