2015-16 May Revision

Edmund G. Brown Jr. Governor, State of California

Introduction

Since the January Budget, the state's economy has strengthened and revenues have surged upward, driven by increased capital gains and other income from high-wage earners.

Despite these stronger revenues, the budget remains precariously balanced and faces the prospect of deficits in succeeding years. The state has hundreds of billions of dollars in existing liabilities, such as deferred maintenance on its roads and other infrastructure and its unfunded liability for future retiree health care benefits for state employees and various pension benefits. In this budget, under Proposition 2, spikes in capital gains will be used to prepare for the inevitable next recession by saving money and paying down these debts and liabilities.

Overall, the May Revision reflects a $6.7 billion increase in General Fund revenues compared to the January Budget. The Constitution, reflecting the voters' priorities, directs the use of these revenues as follows:

- Proposition 98 increases General Fund spending by $5.5 billion for K-12 schools and community colleges.

- Proposition 2 requires that an additional $633 million be saved in the Rainy Day Fund and an additional $633 million be used to pay down debts and liabilities.

Too often in the past, state government has made ongoing commitments based upon what turned out be temporary spikes in revenues — a mistake this budget attempts to avoid. The May Revision commits new spending in only three additional areas:

- Creating the first-ever California Earned Income Tax Credit to assist the state's lowest-income workers. The credit will provide $380 million in benefits to 2 million Californians. This credit — combined with increased funding for education and health care reform, together with an increased minimum wage — will provide increased state support for California's poorest residents.
- Holding tuition flat at the state's universities for California undergraduate students for two more years by providing increased ongoing funding to California State University and temporary assistance to the University of California to pay down its unfunded pension liability.
- Providing health care and other safety net services to currently undocumented immigrants who gain Permanent Residence Under Color of Law status under the President's executive actions.

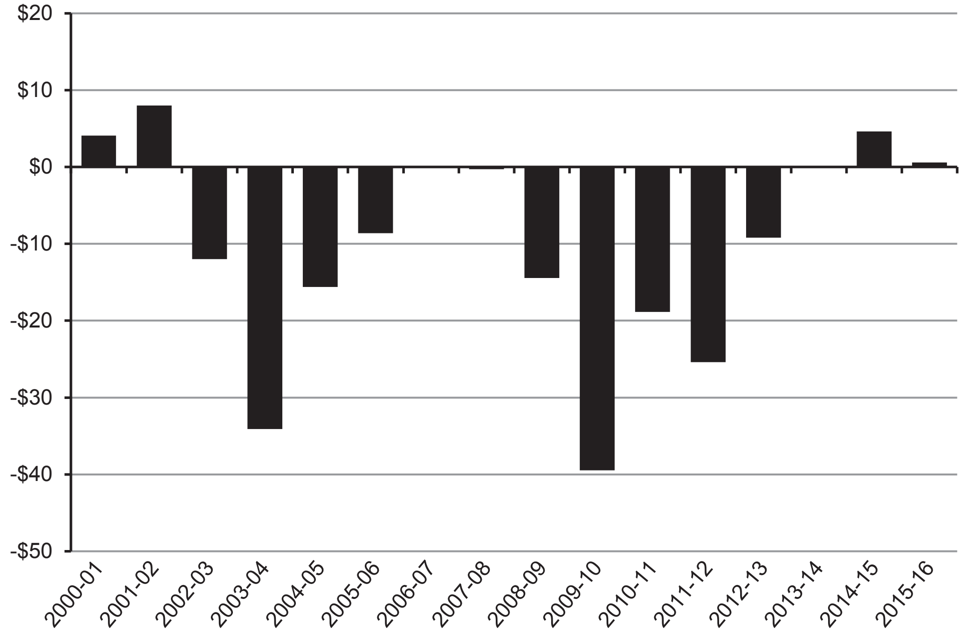
The May Revision continues to focus on the key elements of the January Budget — carrying out the Local Control Funding Formula, federal health care reform, public safety realignment, the Water Action Plan, and the Cap and Trade expenditure plan.

Fiscal Balance Is an Ongoing Challenge

The fiscal stability from a balanced budget and a recovering state economy has been a welcome reprieve from the prior decade's massive budget deficits. Keeping the budget balanced over time will be a challenge — requiring fiscal restraint and prudence. As shown in Figure INT-01, since 2000, the state's short periods of balanced budgets have been followed by massive budget shortfalls.

The Budget assumes the continued expansion of the economy. Yet, as we know, economic expansions do not last. In the post-war period, the average expansion has been about five years, and the current expansion has already exceeded that average by a year. While there are few signs of immediate contraction, another recession is on the way — we just don't know when.

Figure INT-01
Balanced Budgets Have Been Quickly Followed by Huge Deficits[1/]
(Dollars in Billions)



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

Proposition 2 was designed to help the state save when times are good, such as now. Higher revenues from capital gains will both be saved and used to pay down debts. By the end of the year, the state's Rainy Day Fund will have a total balance of $3.5 billion. As shown in Figure INT-02, the May Revision also pays down an additional $633 million in debts and liabilities (for a total of $1.9 billion) from Proposition 2 funds.

Slowly but surely, the state is climbing out from under the budgetary debts accumulated over the past decade and a half. In the next three months alone, the state will:

- Repay the remaining $1 billion in deferrals to schools and community colleges (which once peaked at $10 billion).
- Make the last payment on the $15 billion in Economic Recovery Bonds that were used to cover budget deficits from as far back as 2002.

Figure INT-02

Debts and Liabilities Eligible for Accelerated Payments Under Proposition 2

(Dollars in Millions)

	Outstanding Amount at Start of 2015-16	Governor's Budget Pay Down	Additional May Revision Pay Down
Budgetary Borrowing			
Loans from Special Funds	$3,028	$965	$537
Underfunding of Proposition 98—Settle-Up	1,512	256	0
Unpaid Mandate Claims for Local Governments (prior to 2004-05) [1/]	0	0	0
State Retirement Liabilities			
State Retiree Health	71,773	0	0
State Employee Pensions	43,303	0	0
Teacher Pensions [2/]	72,718	0	0
Judges' Pensions	3,358	0	0
Deferred payments to CalPERS	530	0	0
University of California Retirement Liabilities			
University of California Employee Pensions	7,633	0	96
University of California Retiree Health	14,519	0	0
Total	**$218,374**	**$1,221**	**$633**

1/ Entire liability paid off under the 2014 Budget Act revenue trigger.

2/ The state portion of the unfunded liability for teacher pensions is $14.916 billion.

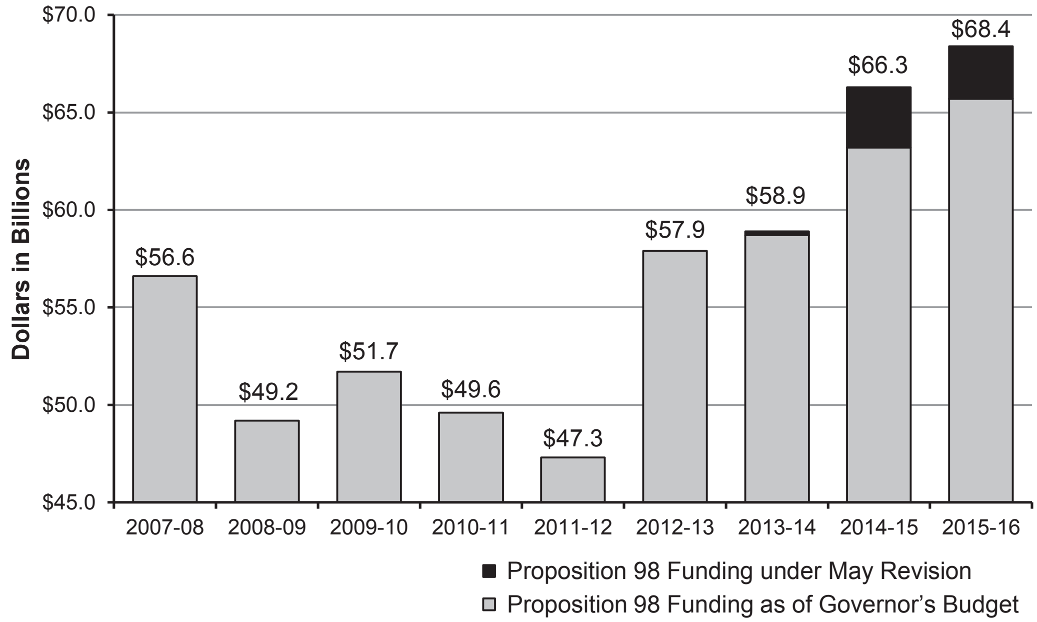
- Repay local governments the final mandate reimbursements for activities completed in 2004 or earlier (totaling $765 million).

The elimination of all of these budgetary debts and a healthier Rainy Day Fund balance will give the state fiscal capacity when the next recession begins. But these steps alone will not ensure an enduring balanced budget. Already, the commitments that the state made in the past two years are straining the state's finances. Under a projection of current policies, the budget would be upside down by more than $2 billion by 2018-19. While forecasts four years into the future are subject to great uncertainty, it is clear that the state cannot take on new ongoing spending commitments beyond those proposed in the May Revision.

More Money for Schools

The Proposition 30 temporary taxes were premised on the need to increase funding for education. As shown in Figure INT-03, the constitutional guarantee of funding for

Figure INT-03
Proposition 98 Funding
2007-08 to 2015-16



K-14 schools was $56.6 billion in 2007-08 and sank to $47.3 billion in 2011-12. From this recent low, funding has been at all-time highs since 2012-13 and is expected to grow to $68.4 billion in 2015-16, an increase of $2.7 billion compared to the level expected in January. The Proposition 98 maintenance factor—an indicator of the past cuts made to schools and community colleges—totaled nearly $11 billion as recently as 2011-12. Under the May Revision, this amount is reduced to $772 million.

K-12 Education

For K-12 schools, funding levels will increase by more than $3,000 per student in 2015-16 over 2011-12 levels. This reinvestment provides the opportunity to correct historical inequities in school district funding with continued implementation of the Local Control Funding Formula. Rising state revenues means that the state can implement the formula well ahead of schedule. When the formula was adopted in 2013-14, funding was expected to be $47 billion in 2015-16. The May Revision provides $6.1 billion more—with the formula instead allocating $53.1 billion this coming year.

Higher Education

The May Revision also invests in the quality and affordability of the state's higher education system. University tuition almost doubled during the recession, creating a hardship for many students and their families. To maintain affordability, the May Revision holds tuition for California undergraduate students flat through 2016-17. The May Revision commits $38 million in ongoing funding for the California State University (CSU), for a total of $158 million in new funding. As part of an agreement with the University of California (UC), the state will provide temporary funding from Proposition 2 to assist in paying down UC's unfunded pension liability—as UC imposes a pension cap consistent with the state's 2012 reform law.

By focusing on reducing the time it takes a student to successfully complete a degree, rather than just admitting more students, the universities can ensure their systems are financially viable over the long term. The community colleges and the university systems must work together to develop innovative approaches so students can successfully complete their degrees. The May Revision provides new funding for CSU and community colleges to coordinate their provision of basic skills and remedial education.

A clear pathway for students to transfer from community colleges to the state's universities is one of the most important features of California's higher education system. For many years, the requirements for transfer to the state's universities were a confusing overlay of individual campus and department rules. Over the past few years, CSU and the community colleges have greatly simplified and improved the transfer process in implementing statewide associate degrees for transfer under Chapter 428, Statutes of 2010 (SB 1440). Over the next two academic years, UC will identify specific pathways for transfer for its 20 most popular majors. These pathways will be closely aligned to the SB 1440 transfer degrees. This will ease the transfer process for students and contribute to UC admitting at least one transfer for every two freshmen by 2017-18.

Counteracting the Effects of Poverty

For the last several years, the Census Bureau has reported that about 16 percent of California residents are living in poverty—slightly above the national average of 14.9 percent. The Census Bureau's supplemental measure of poverty, which considers broader measures of income and the cost of living, reflects a poverty rate of 23.4 percent (a three-year average). While the state's economic conditions have improved since the Governor's Budget, much of the gains continue to be made by the state's wealthiest residents.

California has an extensive safety net for its neediest residents who live in poverty, and the state has maintained those core benefits despite the recession. In the past two years, the recovering economy has allowed the state to take even greater steps to assist the state's neediest residents. These efforts are assisting millions of Californians.

- The implementation of health care reform has extended coverage under Medi-Cal to an additional four million Californians in just three years and added new services such as treatment for substance abuse and mental health. The expansion has already increased General Fund costs by approximately more than $1 billion annually and that amount will rise to more than $2 billion by 2017-18 as the federal government begins to reduce its share of costs beginning in 2017. Under the May Revision, coverage will also be provided to immigrants who gain Permanent Residence Under Color of Law status under the President's executive actions. For Medi-Cal and other programs, this will add General Fund costs of an estimated $200 million when the federal changes are fully implemented ($62 million in 2015-16).
- The Local Control Funding Formula is concentrating the greatest school funding — billions more this year alone — to those students who face the greatest challenges.
- The state increased the minimum wage by 25 percent, to $10 per hour, and guaranteed that 6.5 million workers are eligible for sick leave. General Fund costs to implement these measures will be nearly $250 million by 2016-17.

Despite these steps, millions of Californians remain below the federal poverty line. The Budget takes additional steps to counteract the effects of poverty:

- Establish the state's first Earned Income Tax Credit to help the poorest working families in California. This targeted credit will provide a refundable tax credit for wages and would focus on the lowest-income Californians — households with incomes less than $6,580 if there are no dependents or $13,870 if there are three or more dependents. The proposed credit would match 85 percent of the federal credit at the lowest income levels, providing an average estimated household benefit of $460 annually for 825,000 families (representing 2 million individuals), with a maximum benefit of $2,653.

- Provide $1.4 billion ($150 million more than the Governor's Budget) in funding to support a coordinated framework for adult education, career technical education, workforce investment and apprenticeships.
- Establish an amnesty program for those Californians with past due court-ordered debt from traffic infractions. Participating individuals can reduce their debts by 50 percent, reduce the administrative fees they pay from $300 to $50, and have their drivers' licenses reinstated.

Emergency Drought Response

The State of California has experienced four consecutive years of below-average rain and snow, and is currently facing severe drought conditions in all 58 counties. The most recent surveys recorded the statewide average snowpack, which is the source for one-third of the state's water, at just 2 percent of the normal average. Since the Governor first declared a state of emergency in January 2014, the Administration has worked with the Legislature to appropriate approximately $1.9 billion to assist drought-impacted communities and provide additional resources for critical water infrastructure projects. The state's emergency drought response accelerates several of the key actions in the California Water Action Plan. The May Revision includes an additional $2.2 billion of one-time resources to continue the state's response to drought impacts. The funds will protect and expand local water supplies, conserve water and respond to emergency conditions.

Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2015-16 May Revision
General Fund Budget Summary

(Dollars in Millions)

	2014-15	2015-16
Prior Year Balance	$5,589	$2,359
Revenues and Transfers	$111,307	$115,033
Total Resources Available	**$116,896**	**$117,392**
Non-Proposition 98 Expenditures	$64,929	$65,892
Proposition 98 Expenditures	$49,608	$49,416
Total Expenditures	**$114,537**	**$115,308**
Fund Balance	**$2,359**	**$2,084**
Reserve for Liquidation of Encumbrances	$971	$971
Special Fund for Economic Uncertainties	$1,388	$1,113
Budget Stabilization Account/Rainy Day Fund	**$1,606**	**$3,460**

Figure SUM-02

2015-16 Total State Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$3,180	$3,394	$223	$6,797
Business, Consumer Services & Housing	623	807	140	1,570
Transportation	261	8,855	2,091	11,207
Natural Resources	2,490	1,513	1,100	5,103
Environmental Protection	65	3,116	1,762	4,943
Health and Human Services	31,811	20,788	-	52,599
Corrections and Rehabilitation	10,087	2,581	-	12,668
K-12 Education	49,285	103	1,063	50,451
Higher Education	14,195	103	390	14,688
Labor and Workforce Development	215	681	-	896
Government Operations	739	281	7	1,027
General Government:				
Non-Agency Departments	677	1,861	2	2,540
Tax Relief/Local Government	469	2,284	-	2,753
Statewide Expenditures	1,211	574	-	1,785
Total	**$115,308**	**$46,941**	**$6,778**	**$169,027**

Note: Numbers may not add due to rounding.

Figure SUM-03

General Fund Expenditures by Agency

(Dollars in Millions)

	2014-15	2015-16	Change from 2014-15 Dollar Change	Percent Change
Legislative, Judicial, Executive	$3,017	$3,180	$163	5.4%
Business, Consumer Services & Housing	843	623	-220	-26.1%
Transportation	200	261	61	30.5%
Natural Resources	2,558	2,490	-68	-2.7%
Environmental Protection	87	65	-22	-25.3%
Health and Human Services	30,046	31,811	1,765	5.9%
Corrections and Rehabilitation	10,030	10,087	57	0.6%
K-12 Education	49,659	49,285	-374	-0.8%
Higher Education	13,267	14,195	928	7.0%
Labor and Workforce Development	282	215	-67	-23.8%
Government Operations	754	739	-15	-2.0%
General Government:				
Non-Agency Departments	1,500	677	-823	-54.9%
Tax Relief/Local Government	446	469	23	5.2%
Statewide Expenditures	242	1,211	969	400.4%
Supplemental Payment to the Economic Recovery Bonds	1,606	-	-1,606	-100.0%
Total	**$114,537**	**$115,308**	**$771**	**0.7%**

Note: Numbers may not add due to rounding.

Figure SUM-04

General Fund Revenue Sources

(Dollars in Millions)

	2014-15	2015-16	Change from 2014-15 Dollar Change	Change from 2014-15 Percent Change
Personal Income Tax	$75,384	$77,700	$2,316	3.1%
Sales and Use Tax	23,684	25,240	1,556	6.6%
Corporation Tax	9,809	10,342	533	5.4%
Insurance Tax	2,486	2,556	70	2.8%
Alcoholic Beverage Taxes and Fees	353	360	7	2.0%
Cigarette Tax	84	82	-2	-2.4%
Motor Vehicle Fees	23	23	0	0.0%
Other	1,090	584	-506	-46.4%
Subtotal	**$112,913**	**$116,887**	**$3,974**	**3.5%**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-1,606	-1,854	-248	15.4%
Total	**$111,307**	**$115,033**	**$3,726**	**3.3%**

Note: Numbers may not add due to rounding.

Figure SUM-05

2015-16 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2014-15
Personal Income Tax	$77,700	$1,806	$79,506	$2,355
Sales and Use Tax	25,240	12,757	37,997	1,413
Corporation Tax	10,342	-	10,342	533
Highway Users Taxes	-	4,893	4,893	-828
Insurance Tax	2,556	-	2,556	70
Alcoholic Beverage Taxes and Fees	360	-	360	7
Cigarette Tax	82	688	770	-22
Motor Vehicle Fees	23	6,521	6,544	177
Other	584	18,963	19,547	-2,264
Subtotal	**$116,887**	**$45,628**	**$162,515**	**$1,441**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-1,854	1,854	0	0
Total	**$115,033**	**$47,482**	**$162,515**	**$1,441**

Note: Numbers may not add due to rounding.

K thru 12 Education

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

The May Revision includes total funding of $83 billion ($49.7 billion General Fund and $33.3 billion other funds) for all K-12 education programs.

Proposition 98

A voter-approved constitutional amendment, Proposition 98, 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 recently adopted Local Control Funding Formula is the primary mechanism for distributing funding to support all students attending K-12 public schools in California.

As a result of significant growth in General Fund revenues, Proposition 98 funding obligations increase by a total of $6.1 billion over the three-year period of 2013-14 to

2015-16 relative to the Governor's Budget. Specifically, Proposition 98 Guarantee funding increases by $241 million in 2013-14, $3.1 billion in 2014-15, and $2.7 billion in 2015-16. As a result of these changes, the revised Proposition 98 Guarantee levels at the May Revision for the 2013-14 through 2015-16 fiscal years are $58.9 billion, $66.3 billion, and $68.4 billion, respectively.

The Proposition 98 maintenance factor—an indicator of the past reductions made to schools and community colleges—totaled nearly $11 billion as recently as 2011-12. Under the May Revision, this amount is reduced to $772 million.

K-12 Funding Priorities

The May Revision proposes to utilize this substantial combination of one-time and ongoing resources to further advance the core priorities of the Administration, paying down debts owed to schools, and investing significantly in the Local Control Funding Formula. The formula provides additional funding to school districts and students most in need of these resources. The May Revision maintains the repayment of all the inter-year budgetary deferrals, while substantially increasing funding for the formula by providing an additional $2.1 billion—building upon the more than $4 billion provided in the Governor's Budget. In total, this $6.1 billion investment in the formula will provide enough funding to close 53 percent of the remaining gap to full implementation. The repayment of deferrals and the added investments in the formula will provide greater certainty of funding and address inequities in the prior school finance system, while allowing schools to expand base programs and services and support other key local investments and priorities. Funding is also provided for various workload adjustments under the new formula, as detailed in the K-12 Budget Adjustments section.

The 2013 Budget Act provided $1.25 billion in one-time Proposition 98 General Fund to support the implementation of the recently state-adopted academic standards for English Language Arts and Mathematics—new standards focused on developing the critical thinking, problem-solving, and analytical skills students will need for today's entry-level careers, freshman-level college courses, and workforce training programs.

The Governor's Budget proposed more than $1.1 billion in discretionary one-time Proposition 98 funding for school districts, charter schools, and county offices of education to further the implementation of the state-adopted academic standards. The May Revision significantly expands this investment by proposing an additional $2.4 billion in Proposition 98 resources. With more than $3.5 billion in total discretionary funding, schools will be able to continue to make the necessary investments in professional development, provide teacher induction to beginning teachers, and purchase instructional materials and technology to prepare both students and teachers for success. Of this new total funding, $40 million will be provided to county offices of education to assist schools in meeting new responsibilities required under the accountability structure of the formula. All of the funds provided will offset any applicable mandate reimbursement claims for these entities, which builds off the approach in the 2014 Budget Act where $400.5 million in one-time funding was provided for both general purpose activities and mandates reimbursement. This combined two-year investment will substantially reduce the outstanding mandates debt owed to local educational agencies, consistent with the Administration's goal to pay down debt.

Special Education

The California Statewide Special Education Taskforce was formed in 2013 to examine the state of special education in California, analyze and consider best practices within the state and nation, and ultimately propose recommendations for improving the system. The taskforce, composed of parents, advocates, teachers, administrators, and experts in the field, began meeting in December 2013. After more than a year of deliberations, the taskforce released its final recommendations in March 2015, which focus on the areas of early learning, evidence-based school and classroom practices, educator preparation and professional learning, assessments and accountability structures, family and student engagement, and special education financing.

In response to these recommendations, the May Revision proposes $60.1 million Proposition 98 General Fund ($50.1 million ongoing and $10 million one-time) in 2015-16 to implement selected program changes recommended by the taskforce, and makes targeted investments that improve service delivery and outcomes for all disabled students, with a particular emphasis on early education.

Significant Adjustments:

- Increase Opportunities for Infants and Toddlers to Receive Early Interventions—The May Revision proposes augmenting the Early Education Program for Infants and Toddlers with Exceptional Needs, which identifies and provides early interventions for infants from birth to age two with special needs, by $30 million Proposition 98 General Fund. Participation in the current program is limited to local educational agencies that have historically received state funding for this program.

This investment will allow for new participation in the program, and provide an opportunity for the state to reassess the outdated funding model.

- Increase Opportunities for Children with Exceptional Needs in State Preschool—The May Revision proposes $12.1 million Proposition 98 General Fund to provide access to an additional 2,500 children in State Preschool. Priority for this funding is for children with exceptional needs.
- Improve Outcomes for Children with Exceptional Needs who Participate in State Preschool—The May Revision requires State Preschool programs to: (1) provide parents with information about accessing local resources for the screening and treatment of developmental disabilities, and (2) within existing professional development requirements, provide teachers with training on behavioral strategies and targeted interventions to improve kindergarten readiness. The May Revision proposes increasing State Preschool reimbursement rates by 1 percent (at a cost of $6 million Proposition 98 General Fund) to reflect these changes.
- Establish Statewide Resources to Encourage and Assist Local Educational Agencies in Aligning Systems of Learning and Behavioral Supports—The May Revision proposes a one-time investment of $10 million Proposition 98 General Fund to provide technical assistance and build statewide resources to assist local educational agencies interested in implementing school-wide, data-driven systems of support and intervention. School-wide tiered systems provide scientifically based practices and interventions that are proportional to a student's needs. Research indicates that schools that have implemented tiered systems are more successful at improving disabled student outcomes.
- Increase Dispute Resolution Resources—The May Revision proposes an increase of $1.7 million federal Individuals with Disabilities Education Act state-level activity funds to expand the current Alternative Dispute Resolution Grant Program to all Special Education Local Plan Areas in the state. On a limited scale, this program has proven successful in resolving special education disputes at the local level.
- Increase State Systemic Improvement Plan Resources—The May Revision proposes an increase of $500,000 federal Individuals with Disabilities Education Act state-level activity funds to develop resources and provide technical assistance to local educational agencies for implementation of the federally required State Systemic Improvement Plan for students with disabilities.

Adult Education

The May Revision maintains $500 million Proposition 98 General Fund to establish the Adult Education Block Grant program to provide funds for adult education to school districts and community colleges. This proposed program will coordinate efforts of various entities—such as schools, community colleges, universities, local workforce investment boards, libraries, social services agencies, public safety agencies, and employers—to provide education and training more effectively.

The May Revision strengthens this proposal, substantially informed by feedback received from stakeholders.

Significant Adjustments:

- Eliminate Allocation Boards within Each Consortium—Each consortium will be required to create rules and procedures regarding how it will make decisions, based on state guidelines that require consortia to seek and respond to input on proposed decisions from interested stakeholders and to make decisions publicly.
- Require More Robust, but Less Frequent, Planning—Each consortium will develop a comprehensive plan for adult education in its region at least once every three years, with annual updates.
- Provide Greater Funding Certainty—The Superintendent of Public Instruction and the Chancellor of the California Community Colleges will certify maintenance of effort levels by July 30, and will determine the allocation of any remaining block grant funds to consortia by October 30. Beginning in 2016, the Superintendent and Chancellor will provide preliminary allocations to consortia shortly following the release of each Governor's Budget, and final allocations, along with preliminary projections for two future years, shortly after each Budget is enacted. At the consortia level, allocations to districts will be at least equal to their distribution from the previous year, with limited exceptions. Further, use of a local fiscal administrator is no longer required.
- Integrate Adult Education Programs and Funding Streams—The Superintendent and Chancellor will, by January 31, 2016, develop and submit a plan to distribute Workforce Innovation and Opportunity Act Title II and Perkins funding using the consortia structure in future years. School districts, county offices of education, and community college districts that receive other specified state funds or

federal funds for adult education must be participating members of an adult education consortium.

K-12 Budget Adjustments

Significant Adjustments:

- Career Technical Education—The Governor's Budget proposed $250 million in one-time Proposition 98 funding in each of the next three years to support a transitional Career Technical Education (CTE) Incentive Grant Program. School districts, county offices of education, and charter schools receiving funding from the program would be required to provide a dollar-for-dollar match each year. The May Revision proposes an additional $150 million in 2015-16 for the first year of this transition program, an additional $50 million in 2016-17, and a reduction of $50 million in 2017-18. This adjusted schedule of funding will better allow schools to transition to entirely using their own discretionary funds by 2018-19. The May Revision also proposes a series of other changes to the Administration's January proposal on CTE, including:
    - Increasing the minimum local-to-state funding match requirement to 1.5:1 in 2016-17 and 2:1 in 2017-18, to assist local educational agencies' transition in supporting CTE with their Local Control Funding Formula apportionments and other existing resources after this program expires.
    - Eliminating Career Pathways Trust from the list of allowable sources of local matching funds.
    - Directing the Department of Education and the State Board of Education to give funding priority to applicants administering programs located in rural districts or regions with high student dropout rates.
- Quality Education Investment Act Transition Funding—An increase of $4.6 million one-time Proposition 98 General Fund to provide half of the final apportionment of Quality Education Investment Act (QEIA) funding to selected school districts in 2015-16 that do not qualify for concentration grant funding under the Local Control Funding Formula. This funding will help ease the transition off QEIA funding for districts with isolated concentrations of English learners and students who qualify for free or reduced-priced meals.

- Simon Wiesenthal Center—An increase of $2 million Proposition 98 General Fund for the Los Angeles County Office of Education to contract with the Simon Wiesenthal Center to support the Museum of Tolerance's "Tools for Tolerance" training programs. These funds allow the center to partner with schools throughout the state to advance anti-bias education, inclusion, and equity through professional development programs.
- Local Property Tax Adjustments—A decrease of $123.3 million Proposition 98 General Fund in 2014-15 for school districts, special education local plan areas, and county offices of education as a result of higher offsetting property tax revenues. A decrease of $224 million Proposition 98 General Fund in 2015-16 for school districts, special education local plan areas, and county offices of education as a result of higher offsetting property tax revenues.
- Average Daily Attendance—An increase of $94.4 million in 2014-15 and an increase of $173.5 million in 2015-16 for school districts, charter schools, and county offices of education under the Local Control Funding Formula as a result of an increase in 2013-14 average daily attendance (ADA), which drives projections of ADA in both 2014-15 and 2015-16.
- Proposition 39—The California Clean Energy Jobs Act was approved by voters in 2012, and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision decreases the amount of energy efficiency funds available to K-12 schools in 2015-16 by $6.7 million to $313.4 million to reflect reduced revenue estimates.
- Categorical Program Growth—A decrease of $18.4 million Proposition 98 General Fund for selected categorical programs, based on updated estimates of projected ADA growth.
- Cost-of-Living Adjustments—A decrease of $22.1 million Proposition 98 General Fund to selected categorical programs for 2015-16 to reflect a change in the cost-of-living factor from 1.58 percent at the Governor's Budget to 1.02 percent at the May Revision.
- K-12 Mandated Programs Block Grant—An increase of $1.2 million Proposition 98 General Fund to reflect greater school district participation in the mandates block grant. This additional funding is required to maintain statutory block grant funding rates assuming 100-percent program participation.

Child Care and State Preschool

Subsidized Child Care includes a variety of programs designed to support low-income families so they may remain gainfully employed. These programs are primarily administered by the Department of Education. Additionally, the State Preschool program is designed as an educational program to help children develop the skills needed for success in school. The Department of Education and the Department of Social Services jointly administer the three-stage CalWORKs child care system to meet the child care needs of recipients of aid while they participate in work activities and as they transition off cash aid. Families can access services through centers that contract directly with the Department of Education, or by receiving vouchers from county welfare departments or alternative payment program providers.

Significant Adjustments:

- CalWORKs Stage 2—An increase of $46.8 million non-Proposition 98 General Fund, to reflect an increase in the number of new Stage 2 beneficiaries and an increase in the cost of providing care. Total base cost for Stage 2 is $395.4 million.
- CalWORKs Stage 3—An increase of $2 million non-Proposition 98 General Fund to reflect minor adjustments in caseload and the cost of providing care. Total base for Stage 3 is $265.5 million.
- Capped Non-CalWORKs Programs—A net decrease of $7.2 million ($3.1 million Proposition 98 General Fund and $4.1 million non-Proposition 98 General Fund) to reflect a change in the cost-of-living adjustment from 1.58 percent at the Governor's Budget to 1.02 percent at the May Revision, and a net decrease of $2.5 million ($1.1 million Proposition 98 General Fund and $1.4 million non-Proposition 98 General Fund) to reflect a change in the population of 0-4 year-old children.
- Child Care and Development Funds—A net increase of $17.7 million federal funds in 2015-16 to reflect an increase in ongoing base federal funds of $9 million, an additional $5.5 million in one-time general-purpose funds from 2014-15, and an additional $3.2 million in one-time quality funds from 2014-15. In addition, the May Revision identifies basic priorities for possible mid-year federal Child Care and Development Block Grant funding adjustments, and establishes the Infant and Toddler Quality Rating and Improvement System Block Grant with anticipated federal quality funds available beginning October 1, 2016.

- State Preschool—An increase of $13.5 million Proposition 98 General Fund to reflect 2,500 part-day State Preschool slots as described in the Special Education section, as well as various technical adjustments including an adjustment in the cost of living and a change in the population of 0-4 year-old children.
- Early Head Start/Child Care Partnership Grant—An increase of $2.4 million federal funds to provide Early Head Start services to an additional 260 infants and toddlers in 11 northern counties.

Commission on Teacher Credentialing

The Commission on Teacher Credentialing sets the State's standards for educator preparation for the K-12 public schools of California. The Commission implements these standards through the issuance and renewal of teaching and services credentials, development and administration of educator examinations, accreditation of educator preparation programs, and monitoring of educator conduct. The Commission consists of 19 members: 15 voting members and four ex-officio non-voting members.

The Commission is a special fee agency, with teacher credential fees providing approximately 85 percent of its revenue base; the remainder is provided by examination fees paid by educators and accreditation fees paid by educator preparation programs. Over the past five years, the number of candidates enrolled in and completing educator preparation programs and applying for credentials has declined, resulting in a decrease in the Commission's revenue base. At the same time, the Commission's non-discretionary operating costs have continued to increase. The May Revision includes $4.5 million in additional funding to address these costs. To address the structural pressures on the Commission's budget in the near term, the May Revision proposes to increase the teacher credential fee to $100 for initial and renewal credentials in an effort to provide the Commission with additional revenue necessary to support mission-critical activities. Credential fees had been held flat at $55 since 2000, until the fee was raised to the current level of $70 in 2012. Even with this proposed increase, teacher credential fees would remain lower than renewal fees charged to professionals in a number of other occupational fields.

To address some of the long-term underlying causes of the Commission's current structural budget issues, it is important to streamline functions and create workload efficiencies at the Commission. The Administration proposes to begin this effort with a focus on the Commission's responsibility to monitor educator misconduct through the existing district reporting process. Often, the evidentiary files of district-reported cases of teacher misconduct are incomplete and lack basic information, which increases processing time and costs. While the minimum required information is currently specified in regulations, the Administration proposes to place these requirements in statute in an effort to emphasize the basic information needed in a district report of teacher misconduct. The Administration also proposes to provide the Commission with jurisdiction to investigate a superintendent or charter school administrator who fails to report educator misconduct. Both of these changes are intended to improve the quality of these reports, allowing the Commission to act more quickly in determining the correct course of action in each of these cases and ultimately reach a more efficient disposition of each case.

Public Schools on Military Installations

The U.S. Secretary of Defense established a program to construct, renovate, repair, or expand elementary and secondary public schools on military installations to address capacity or facility condition deficiencies. The program is 80 percent federal funded, with a 20-percent local match requirement for a school district to receive funding under the program.

In 2010, the Department of Defense assessed the condition of 160 public schools on military installations in the United States and created a priority list of schools with the most serious condition and/or capacity deficiencies. California has 11 schools located in six school districts that are within the top 33 of the priority list. The majority of schools on this list have expressed concerns about raising the required 20-percent local match. In an effort to assist participating districts, the Administration is exploring several funding options to help the eligible schools establish their local match, including the provision of low-interest state loans through existing programs.

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 Master Plan for Higher Education created a model for public education throughout the world. The segments must serve as leaders to keep the costs of higher education affordable for students and families. The Administration expects segments to continue to improve efficiencies and innovations, and ensure investments are student-centered to the benefit of current students and increased access for current and future Californians.

The May Revision includes total funding of $29.1 billion ($16.6 billion General Fund and local property tax and $12.6 billion other funds) for all programs included in these entities.

California Community Colleges

The CCC are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.1 million students. The CCC system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 72 educational centers. By providing education, training, and services, the CCC contribute to continuous workforce improvement and also provide remedial instruction for hundreds of thousands of adults across the state through basic skills courses and adult non-credit instruction. The CCC also provide students an economic alternative through the transfer pathway to obtain a four-year degree.

The significant resources—$619 million above the Governor's Budget and $1 billion over the 2014 Budget Act level—included in the May Revision for the CCC will enhance student success, including providing more support to students, increasing full-time faculty, and identifying, developing, and expanding the use of effective practices.

Significant Adjustments:

- Apportionments—An increase of $60.3 million Proposition 98 General Fund in 2015-16 to reflect an increase in growth from 2 percent to 3 percent, the inclusion of enrollment restoration, and a reduction in the statutory cost-of-living adjustment from 1.58 percent to 1.02 percent. The May Revision provides $259.4 million Proposition 98 General Fund, as follows:
    - $156.5 million available for general apportionment growth;
    - $61 million for a 1.02-percent cost-of-living adjustment; and
    - $41.9 million to allow colleges to earn back enrollment funding for declines in enrollment over the past two years, as allowed in statute. This funding was inadvertently excluded from the Governor's Budget.
- Increased Operating Expenses—An increase of $141.7 million Proposition 98 General Fund, for a total of $266.7 million, to reflect increased base allocation funding in recognition of increasing community college operating expenses in the areas of facilities, retirement benefits, professional development, converting faculty from part-time to full-time, and other general expenses.
- Full-Time Faculty—An increase of $75 million Proposition 98 General Fund to increase the number of full-time faculty within each community college district. Funding would be allocated based on full-time equivalent enrollment to all community college districts, but community college districts with relatively low proportions of full-time faculty will be required to increase their full-time faculty more than districts with relatively high proportions of full-time faculty. In total, it is expected that approximately 600 full-time faculty positions will be created by this proposal.
- Basic Skills and Student Outcomes Transformation Program—An increase of $60 million Proposition 98 General Fund to assist community colleges in improving delivery of basic skills instruction by adopting or expanding the use of evidence-based models of placement, remediation, and student support that accelerate the progress of underprepared students toward achieving postsecondary educational and career goals.

- Basic Skills Partnership Pilot Program—An increase of $2 million Proposition 98 General Fund for a pilot program to provide incentives to community college districts and the CSU to coordinate their efforts to provide instruction in basic skills to incoming CSU students in an efficient and effective way.
- Investing in Student Success—An increase of $15 million Proposition 98 General Fund to further close achievement gaps in access and achievement in underrepresented student groups, as identified in local Student Equity Plans. Further, to provide additional support to foster youth, the May Revision proposes to implement Chapter 771, Statutes of 2014 (SB 1023). This legislation specifies additional services for foster youth already participating in the Extended Opportunity and Services program at up to ten community colleges.
- Implementing Statewide Performance Strategies—An increase of $15 million Proposition 98 General Fund to implement strategies to improve college performance in student success and outcomes. Of this amount, $3 million will provide local technical assistance to support the implementation of effective practices across all districts. The additional $12 million will develop and disseminate effective professional, administrative, and educational practices, including the specific development of curriculum and practices for members of the California Conservation Corps and for inmates to support the effective implementation of Chapter 695, Statutes of 2014 (SB 1391). Further, the May Revision proposes an increase of $340,000 General Fund and six positions for the Chancellor's Office to continue its district assistance to improve student success and outcomes, and to coordinate efforts to encourage adoption of effective practices at community colleges throughout California.
- Deferred Maintenance and Instructional Equipment—An increase of $148 million one-time Proposition 98 General Fund that colleges can use to reduce their backlog of deferred maintenance or to purchase instructional equipment. Community colleges will not need to provide matching funds for deferred maintenance in 2015-16. These resources will allow districts to protect investments previously made in facilities, and to improve students' experience by replenishing and investing in new instructional equipment.
- Mandate Backlog Payments—An increase of $274.7 million one-time Proposition 98 General Fund, for a total of $626 million, to continue paying down outstanding mandate claims by community colleges. These payments will be distributed on a per full-time equivalent student basis and will further reduce outstanding mandate debt, while providing community colleges with one-time resources to address various

one-time needs, such as curricula redesign, start-up costs for new career technical educational programs, and other one-time costs.

- Categorical Program Cost-of-Living Adjustment—An increase of $2.5 million Proposition 98 General Fund to provide a cost-of-living adjustment 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.

- Proposition 39—The California Clean Energy Jobs Act was approved by voters in 2012 and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision decreases the amount of energy efficiency funds available to community colleges in 2015-16 by $825,000 to $38.7 million to reflect reduced revenue estimates.

- Local Property Tax Adjustment—A decrease of $156.1 million Proposition 98 General Fund in 2015-16 as a result of increased offsetting local property tax revenues.

- Student Enrollment Fee Adjustment—An increase of $7.4 million Proposition 98 General Fund as a result of decreased offsetting student enrollment fee revenues.

- Community College Mandates Block Grant—A decrease of $691,000 Proposition 98 General Fund to align mandate block grant funding with the revised full-time equivalent students estimate.

California State University

With 23 campuses, CSU is the largest and most diverse university system in the country, providing undergraduate instruction, graduate instruction through master's degrees, and doctoral degrees in some fields of study. The CSU plays a critical role in preparing the workforce of California, awarding more than 103,000 degrees in 2013-14; it grants more than one-half of the state's bachelor's degrees and one-third of the state's master's degrees. The CSU awards more degrees in business, engineering, agriculture, communications, health, and public administration than any other California institution of higher education. More than 50 percent of California's teachers graduated from CSU.

Consistent with the Administration's plan reiterated in the Governor's Budget, the CSU has announced it will not increase systemwide tuition and fees in 2015-16.

The university's decision will preserve access by keeping a CSU education affordable for students.

Furthermore, at the CSU Trustees' March meeting, the Chancellor's Office reported on a number of initiatives already underway at CSU campuses to manage operations more efficiently and generate savings. These savings can be redirected toward higher priorities, consistent with the budget approved by the Trustees in November.

The Governor's Budget proposed $119.5 million General Fund ongoing for CSU with similar 4-percent increases in future years, as well as $25 million General Fund on a one-time basis for deferred maintenance at CSU campuses. The CSU has indicated that it would use the additional resources proposed in the Governor's Budget for the following:

- Fund existing obligations, such as increased costs for pensions and health benefits.
- Increase employee compensation systemwide by 2 percent.
- Support the costs of the enrollment of about 4,000 additional students.
- Address backlogs in critical maintenance and infrastructure.

In its annual performance report to the Governor and the Legislature, the CSU indicated that about 19 percent of students who enter as freshmen graduate within four years. The four-year rate for low-income students (12 percent) is about half that of their peers (24 percent), and that gap persists after six years, when 48 percent of low-income students will have graduated, compared to 59 percent for their peers. About half of CSU students transferred from the community colleges—an important role the CSU has embraced within California's higher education system. Nearly 30 percent of transfer students graduate within two years, and low-income transfer students graduate at close to the same rates as their peers.

Shortening the time it takes undergraduates to graduate and increasing the number who complete their degrees is critical for students and their families, and improves access for future students. The CSU chancellor has committed to addressing these challenges. The CSU's Graduation Initiative sets goals to be achieved by the year 2025, including a four-year graduation rate for freshman entrants of 24 percent and a two-year rate for transfer students of 35 percent. The CSU will report publicly on its progress toward these goals as it aims to meet or exceed these targets and timelines.

Significant Adjustments:

- Base Adjustment—An additional $38 million General Fund ongoing for the CSU. With these additional resources, the Administration expects the University to:
    - Support efforts to improve student success at all of the campuses, as approved by the Trustees. Over the long term, reducing the time it takes students to complete degrees should provide access to significant numbers of new students and significant savings to students and families.
    - Enroll more transfer students beginning in the coming year. While timelier completion should improve access to the CSU, the Administration recognizes the demand campuses are facing today, particularly from transfer students who have completed associate's degrees for transfer and are guaranteed admission to the university. The additional funds will allow campuses to enroll approximately 1,500 more transfer students by the spring of 2016.
- Basic Skills Partnership Pilot—As discussed in the California Community Colleges section, the May Revision proposes a pilot program to offer basic skills education to incoming CSU students who need remediation through community colleges. As more of this instructional workload is handled through the community colleges, the CSU can redirect resources to continuing improvements on time to degree.
- Energy Projects—As discussed in the Cap and Trade chapter, the May Revision proposes $35 million Greenhouse Gas Reduction Fund for energy projects at CSU campuses.

University of California

Consisting of 10 campuses, the University of California (UC) is the primary institution authorized to independently award doctoral degrees and professional degrees. The UC educates approximately 249,000 undergraduate and graduate students and receives the highest state subsidy per student among the state's three public higher education segments.

Following the UC Regents' November action to authorize the UC President to increase student tuition by up to 28 percent over five years, the Administration and the President undertook a review of UC as part of a select advisory committee established by the Regents to develop and evaluate proposals to reduce the University's cost structure, while maintaining or improving access, quality, accountability and outcomes.

After months of data review, discussions between the Administration and the Office of the President, and interviews with higher education experts, faculty and staff at UC campuses, and undergraduate and graduate students, the Governor and the UC President have agreed that UC will undertake a number of reforms to manage its operations more effectively and that the President will strongly recommend the Academic Senate undertake additional reforms. Implementation of these reforms will allow UC to better serve existing students and reduce its future operating costs so that students will have access to an affordable UC education in the years to come. Under this framework, tuition for California undergraduate students will remain flat through 2016-17. As UC implements a cap on salary eligible for pensions consistent with the state's 2012 pension reform law, the state will use the dedicated debt funding under Proposition 2 to help reduce the University's unfunded pension liability. The agreed-upon framework is described in more detail below.

State Funding Has Increased Substantially

Between 2007-08 and 2014-15, nearly all state-supported programs experienced steep declines in their General Fund revenues given the magnitude of the Great Recession. With a recovering economy and the passage of Proposition 30, the state has been able to reinvest and expand services in targeted ways. For UC, the passage of Proposition 30 averted a $250 million cut to university funding and provided a total of $392 million in new resources in 2014-15. In addition to these increases, by 2015-16, Cal Grant and Middle Class Scholarship expenditures for UC students are now estimated to be $900 million and have grown by nearly $600 million since 2007-08 (more than 200 percent) principally due to tuition increases.

Tuition Increases Are Not Needed at This Time

Of UC's total resources, estimated to be nearly $28 billion in 2014-15, the University indicates that about $7 billion is available to support student instruction. The UC's proposed budget identifies $125 million for existing obligations, including compensation increases pursuant to already-negotiated labor contracts, costs of employee benefits, and adjustments in current spending for inflation. To assist the University with these costs, provide funding for all currently enrolled students, allow for additional discretionary spending, and reduce energy use, the Administration is committed to providing the following in the budget year:

- $119.5 million in increased General Fund on an ongoing basis.

- $25 million in one-time General Fund for deferred maintenance.
- $25 million in one-time Cap and Trade revenues, which would be used for energy efficiency projects at UC campuses to reduce greenhouse gas emissions.

With these state resources, the University has committed to freezing undergraduate tuition for California residents for 2015-16 and 2016-17. The Administration's multi-year plan will continue to provide 4-percent increases in direct General Fund support in future years. By 2017-18, tuition will have remained flat for six consecutive years, and it is reasonable to expect that tuition will begin to increase modestly and predictably, likely close to the rate of inflation. In the intervening years, UC must aggressively implement the reforms below and continue its efforts to obtain administrative efficiencies.

Agreement Improves Transfer Opportunities for Community College Students

Transfer to UC can be a cost-effective pathway for students. For example, attending a community college for two years before transferring to UC can result in $25,000 of savings for a student in tuition and fees alone. The community colleges are diverse—40 percent of enrolled students are Latino while about 7 percent are African American, and recent reports have found that a majority of Latino graduating high school seniors enroll at the community colleges. Expanding the number of students who successfully complete their lower-division requirements at the community colleges will allow the University to be more diverse and serve far more Californians.

Since the passage of Chapter 428, Statutes of 2010 (SB 1440), CSU and the community colleges have greatly simplified the transfer process by developing associate' degrees for transfer that guarantee admission to CSU with junior standing once the degree is obtained. The process eliminates campus-by-campus and major-by-major transfer requirements and establishes clear expectations for students.

The UC has also taken steps to simplify the process for transfer students. Over the next two academic years, for its 20 most popular majors, UC will articulate specific pathways for transfer that are closely aligned to the associate's degrees for transfer established by community colleges and CSU pursuant to SB 1440. Any differences will be clearly identified so that students know exactly what is needed for transfer to both CSU and UC.

Currently, UC has a goal of a two-to-one ratio of incoming freshmen to transfers—but only three campuses meet this expectation. The improved transfer process, combined with a commitment from UC to reach the two-to-one transfer threshold by 2017-18 (for all undergraduate campuses except for UC Merced), will open up transfer opportunities to thousands more students in the coming years.

Improved Time-to-Degree Will Further Expand Access

In recent years, admission to UC has become increasingly selective. The Master Plan for Higher Education specifies that any student in the top one-eighth of the state's high-school graduating class each year should be eligible to attend UC, the University should establish a ratio of students in the lower division to those in the upper division of two to three, and students transferring from California community colleges should receive priority in admissions.

The University can increase access for qualified students in several ways. By improving four-year graduation rates for students who enter as freshmen and two-year graduation rates for transfer students, the University could serve far more Californians within its current infrastructure. For example, of the 37,000 students who entered as freshmen in the fall of 2008, 62 percent of students graduated within four years—while 81 percent finished within five years and 83 percent graduated within six years. Improving four-year completion even modestly would open up admission for hundreds to thousands of new freshmen and transfer students.

To support focused degree pathways, all undergraduate UC campuses will undertake a comprehensive review of the courses necessary in 75 percent of majors and complete this review by July 1, 2017, other than UCLA, which has already completed this review. The initiative, modeled after UCLA's "Challenge 45," has the goal of reviewing the number of courses and reducing those requirements to no more than 45 units where possible. This challenge encourages a thoughtful approach to how undergraduate programs are designed and helps eliminate any unnecessary requirements for graduation.

In addition, the UC President will strongly encourage the Academic Senate to review existing policies on credits for Advanced Placement courses and College Level Examination Program tests and use of the Common Identification Numbering System (C-ID), which is already used by the community colleges and CSU. These policies would further streamline the processes to award credit by examination and transfer credit from other institutions and provide the opportunity for students to graduate sooner than otherwise would be the case.

Three campuses will pilot alternative pricing models for summer session by 2016. Currently, the summer term does not take full advantage of existing infrastructure and instructional capacity. These pilots will identify options to encourage undergraduate students to take more courses during the summer with the intent to further expand the use of summer courses in future years.

In addition to supporting timely four-year degrees, each campus will develop three-year degree pathways for 10 out of its top 15 majors by March 1, 2016, which will provide students with another option to earn a UC degree. The UC has committed to promoting and encouraging these accelerated pathways with a goal that 5 percent of students will access these accelerated tracks by the summer of 2017. While accelerated graduation is not practical for all, improved time-to-degree results in significant savings for students and families, and students should have clear, specific options that allow them to graduate in a timely way that best suits their needs. Increasing the number of students who complete their degrees in less than four years would also open up admission to hundreds of new undergraduates.

These policy changes can have significant impacts if students receive appropriate guidance as they move through their programs. Therefore, the Office of the President will work with campus advisors on how they can help keep students on track for graduation within four years or less.

University Operations Should be Optimized Using Technology

As technology evolves, new opportunities exist for the University to improve its operations. Innovative universities are using software and information to better understand the costs associated with higher education, measure student needs and improve outcomes. Technology is enabling more responsive teaching and learning; innovative course planning and course redesign; and better financial modeling, such as activity-based costing (ABC) used by many leading businesses. All of these tools can help focus resources where they are needed most—whether it is helping students plan their course of study, guiding faculty in determining when and how to provide more targeted instruction, showing advisors which students are struggling, or providing administrators with data to determine course offerings that can dissipate bottlenecks. All campuses should evaluate how they can deploy these and other advancements to better support students.

By pursuing several technologies at each campus, UC can serve as a laboratory for new practices in teaching and learning. As part of the agreement with the Administration, UC Riverside will pilot ABC tools for its College of Humanities, Arts and Social Sciences, which houses 20 departments. Two additional campuses will also participate on a smaller scale, with three similar departments reflecting the most popular disciplines piloting ABC in 2016 following a scoping study. Campuses will also report on how they are using other data and technology tools, such as predictive analytics, to identify students at risk of repeating courses, not completing on time, or needing advising or other interventions. These data can be used to close achievement gaps among students. Finally, UC Davis will lead a multi-campus pilot (with at least two other campuses) on deploying adaptive learning technologies, focused on improving instruction and increasing the number of students who succeed in difficult courses and persist to completion.

In addition to understanding costs and outcomes, technology offers new opportunities for increasing access to UC. Today, students can connect with professors across campuses, and professors can lecture online and spend more time with students in discussion groups. During the Administration's review, many faculty members cited hybrid courses as a way to deliver an enhanced learning environment to more students than in a typical lecture course. Supporting the development of hybrid courses—especially for bottleneck courses, courses with high failure rates, or courses that are needed for popular majors—should be a priority of the University, as doing so can help enhance student outcomes, lower costs and increase access. Using a General Fund augmentation provided in recent years, UC established the Innovative Learning Technology Initiative, and with that continued funding, UC will expand its impact on students by prioritizing resources on the development of these courses.

The UC has also committed to expanding online programs in strategic areas where high demand exists to help Californians meet the workforce needs of employers. To that end, UC will convene industry leaders and other stakeholders this summer to identify online certificate and master's degree programs that would provide significant benefit to the California workforce. The UC will also seek to expand enrollment in existing online programs that have proven to be successful.

Long-Term Obligations Must Be Addressed

For two decades, UC took a "pension holiday" from annual contributions to its defined benefit retirement system and instead relied on unsustainable investment returns. Combined with the stock market crash of the Great Recession, this holiday left the

University's retirement system with billions in unfunded liabilities. In valuations presented to the Regents in November, the University's actuaries estimated unfunded liabilities of $7.6 billion for its pension system, as well as an additional $14.5 billion for health care for its retirees.

Beginning in 2010, both the University and employees renewed their contributions to the UC Retirement Plan. In 2015-16, campuses will contribute 14 percent of payroll, while most employees will pay 8 percent of their earnings. These new costs have represented a major operational pressure at the campus level.

Other California governments face similar long-term liabilities. Chapter 296, Statutes of 2012 (AB 340), established the Public Employees' Pension Reform Act of 2013 (PEPRA). The statute provides lower pension benefits and requires higher retirement ages for new employees in state and local governments and schools.

The UC made similar changes to the design of its retirement program and complied with the Internal Revenue Service (IRS) cap on salaries eligible for pensions. However, the IRS cap is more than double the salary cap that was adopted in 2012 under PEPRA, which prevents workers from receiving pensions far beyond what is reasonable. Currently under PEPRA, the state imposes a cap on pensionable earnings of $117,020 for employees who are eligible for Social Security benefits. The UC has a much higher limit—$265,000—for its pension program. By July 1, 2016, the Regents will adopt a pension program for new employees in which an employee can elect either a defined benefit plan that includes a PEPRA cap (with, for some employees, a supplemental defined contribution plan) or a full defined contribution plan. By creating a program consistent with PEPRA, the University will be eligible to receive Proposition 2 funds to pay down existing pension debt. The state would provide $96 million in 2015-16, with an additional roughly $170 million in each of the next two years to cover unfunded pension debt in each of those three years. As the unfunded liability decreases in future years, the University will reduce its costs and long-term risk.

Lowering the Cost Structure of the University Will Require Ongoing Engagement

As the state continues to reinvest in higher education, the state has an opportunity to ensure those investments provide the highest value for students, their families and the public. The Governor and the Legislature now require the University to report annually on its performance and every two years on the amount it spends on undergraduate students and graduate students. By reporting data in new ways, managers at each of the campuses can better understand the interaction between cost and academic performance, and the University's leaders can better share with the public credible information about the costs of instruction, research and public service.

The agreement forged between the Administration and the University of California will allow UC to better use both state taxpayer and student tuition dollars. The Administration expects regular reporting on these efforts, including status updates and ongoing evaluation. The Administration intends to continue to partner with the Office of the President, as well as UC students, faculty, and campus leaders to lower the cost structure of the University in ways that support access, affordability, quality, and improved outcomes.

California Student Aid Commission

The California Student Aid Commission administers state financial aid to students attending institutions of public and private postsecondary education through a variety of programs including the Cal Grant High School and Community College Transfer Entitlement programs, the Competitive Cal Grant program, the Middle Class Scholarship Program, and the Assumption Program of Loans for Education. More than 125,000 students received new Cal Grant awards, and more than 170,000 students received renewal awards in 2013-14.

The May Revision continues to focus financial aid for students attending the state's public higher education institutions and other institutions to minimize student debt loads and produce successful graduates. This benefits students demonstrating a high likelihood of completing their degrees or programs and students with the greatest financial need.

Significant Adjustments:

- Cal Grant Program Costs—A decrease of $54.2 million General Fund in 2014-15 and $42.2 million General Fund in 2015-16 to reflect revised estimates of participation in the Cal Grant program.
- Offset Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements—An increase of $247.3 million TANF reimbursements in 2015-16, which reduces the amount of General Fund resources needed for program costs. Combined with the TANF reimbursements included in the Governor's

Budget, the May Revision offsets $533.6 million in General Fund costs for Cal Grants in 2015-16.

- Cal Grant B Access Award Supplement—An increase of $1.9 million College Access Tax Credit Fund in 2015-16 to fund a supplemental award of $8 for each student who receives a Cal Grant B Access Award.
- Loan Assumption Program Costs—A decrease of $1.2 million General Fund in 2014-15 and $399,000 General Fund in 2015-16 to reflect revised estimates of costs for the Assumption Program of Loans for Education and the State Nursing Assumption Program of Loans for Education.
- Middle Class Scholarship Program—A decrease of $18 million General Fund in 2014-15 to reflect revised estimates of costs for the Middle Class Scholarship Program.

Awards for Innovation in Higher Education

The Awards for Innovation in Higher Education recognize higher education institutions that improve policies, practices, and/or systems to achieve the state's goals.

Significant Adjustments:

- Additional Program Funding—An increase of $25 million Proposition 98 General Fund to bring total funding for the program for the budget year to $50 million. The May Revision also proposes that community colleges, in addition to California State University campuses, may be lead applicants for awards. The May Revision further proposes that the program be more closely aligned to achieve the state's goals for higher education articulated in Chapter 367, Statutes of 2013 (SB 195).
- Current Year Funding Allocation—A decrease in General Fund and a corresponding increase in Proposition 98 General Fund of $23 million to reflect the actual awards of funds for the current year coordinated by community colleges.

California State Library

Since 1850, the California State Library has promoted innovative library services statewide, ensuring that all Californians have access via their local libraries to information and educational resources.

Significant Adjustments:

- Literacy Program—An increase of $2 million General Fund for the Literacy and English Acquisition Services Program. As described in the Governor's Budget proposal for adult education, the Administration's focus remains on increasing the resources available to improve the skills of California's workforce, and it is expected that literacy programs funded with these resources will be coordinated with the adult education consortia.
- Broadband Project—An increase of $1.7 million General Fund for the California Public Library Broadband Project, including $1.5 million on a one-time basis for grants to public libraries to upgrade broadband equipment and $225,000 General Fund for continued administration of contracts for broadband services.
- Library Preservation Activities—An increase of $521,000 General Fund to improve the library's efforts to preserve historical items in its possession, including $181,000 ongoing for two additional positions and $340,000 on a one-time basis for equipment.

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Health and Human Services

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

The May Revision includes total funding of $140.5 billion ($31.6 billion General Fund and $108.9 billion other funds) for all programs overseen by this Agency, a decrease of $121 million General Fund compared to the Governor's Budget.

Presidential Immigration Actions

On November 20, 2014, the President announced executive actions that would allow certain undocumented immigrants to temporarily remain in the United States without fear of deportation. These actions were intended to provide stability to the immigrants' families and boost the economy.

These individuals would be recognized as having Permanent Residence Under Color of Law due to their "deferred action" status, and/or because the U.S. Citizenship and Immigration Services recognizes their presence in the U.S. and does not intend to deport them.

Permanent Residence Under Color of Law status qualifies individuals for state-funded full-scope Medi-Cal, In-Home Supportive Services, and Cash Assistance Payments for Immigrants. Under federal rules, the status does not allow individuals to qualify for Covered California, CalFresh, CalWORKs, or the California Food Assistance Program.

On February 16, 2015, a federal district court enjoined implementation of these actions. The Obama Administration has appealed and if the Administration prevails, the annual costs to provide the state benefits would be approximately $200 million General Fund, and grow thereafter. The May Revision includes partial-year 2015-16 costs of $62 million General Fund, which presumes the courts allow the federal government to proceed with implementing the executive actions. In conjunction with the President’s executive actions, the May Revision proposes an additional $5 million for direct assistance for immigrant applicants and temporary workers.

Significant Adjustments:

- Immigration Application Assistance—The May Revision includes $5 million General Fund in the Department of Social Services for grants to non-profit organizations to provide application assistance to undocumented immigrants eligible for deferred action under the President's executive actions.
- Temporary Worker Pilot Program—The May Revision includes $148,000 General Fund and one position for the Labor and Workforce Development Agency to implement a voluntary 2-year pilot program to help prevent abuses in the recruitment of temporary workers. This program will improve coordination, maximize efficiency, and increase the effectiveness of various labor programs that serve and protect more than 800,000 farmworkers.

High-Cost Drugs

The May Revision allocates $228 million of the $300 million that was set aside for high-cost drugs in the Governor’s Budget to the Department of Health Care Services, the Department of State Hospitals, and the Department of Corrections and Rehabilitation. This amount includes funding for implementing expanded clinical guidelines that are largely consistent with national clinical recommendations for the treatment of Hepatitis C. Additionally, the California Health and Human Services Agency has held several meetings with counties, sheriffs, stakeholders, and state departments to discuss the clinical, procurement, and cost-benefit considerations around the new Hepatitis C treatments and future high-cost drugs.

Going forward, the Agency will convene two workgroups with state departments and local entities to discuss clinical and procurement issues with the goal of developing a proposal for inclusion in the 2016-17 Governor's Budget. The clinical workgroup will discuss high-cost drugs that are pending federal approval and how they could affect existing clinical guidelines. The procurement workgroup will examine aspects of relevant entities' pharmacy benefit manager contracts, the availability of pricing information, and the activities and functions of state entities procuring drugs or negotiating prices and supplemental rebates.

Department of Health Care Services

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

Significant Adjustments:

- Children's Health Insurance Program (CHIP) Reauthorization—On April 16, 2015, the President signed the Medicare Access and CHIP Reauthorization Act. The Act reauthorizes CHIP through September 2017 and includes enhanced federal funding for the CHIP program effective October 1, 2015. The May Revision includes General Fund savings of $381 million in 2015-16.

- Health Homes Program—The May Revision includes $61.6 million in non-state funds for additional payments to health plans that participate in the Health Homes Program beginning January 2016. Chapter 642, Statutes of 2013 (AB 361), permits DHCS to develop a health homes program that would enhance care management and coordination for beneficiaries with complex needs. The program will provide comprehensive care management, care coordination, health promotion, comprehensive transitional care, individual and family support, and referral to community and social support services. The program will be funded primarily through federal funds, with the non-federal funding coming from non-state sources.

Health Care Reform Implementation

California continues its implementation of the federal Affordable Care Act (ACA). Since January 1, 2014, more than 5 million Californians have obtained health insurance, either through the state's new insurance exchange (Covered California) or through Medi-Cal. Total Medi-Cal enrollment is now projected to be 12.4 million in 2015-16, or nearly one-third of California's total population.

The mandatory Medi-Cal expansion simplified eligibility, enrollment, and retention rules that make it easier to get on and stay on the program. The May Revision includes costs of $2.9 billion ($1.4 billion General Fund) in 2015-16 related to the mandatory expansion. California will split these costs with the federal government. Mandatory expansion caseload is estimated to be 1.4 million in 2015-16.

The optional expansion extended eligibility to adults without children, and parent and caretaker relatives with incomes up to 138 percent of the federal poverty level. The May Revision includes costs of $14 billion in 2015-16 for the optional Medi-Cal expansion. The federal government has committed to pay 100 percent of the cost of this expansion for the first three years. California will begin contributing to these costs in 2016-17, and by 2020-21, the state will pay 10 percent of the total costs. By 2018-19, the General Fund share for the optional expansion is estimated to be $1 billion. The May Revision projects optional expansion caseload to be 2.3 million in 2015-16.

California also increased the mental health and substance use disorder benefits available through Medi-Cal, at a General Fund cost of $341 million in 2015-16.

The May Revision also includes $125 million General Fund for managed care rate increases in 2015-16.

Due to the continuing workload associated with implementing eligibility changes at the county eligibility offices, the May Revision includes an additional $150 million ($48.8 million General Fund) in 2015-16 for ACA-related eligibility determination workload. The ACA implementation has necessitated manual system workarounds that require additional resources. As the state and counties gain experience with the new processes and the eligibility system stabilizes, the state and counties will reevaluate the Medi-Cal county administration budget pursuant to Chapter 442, Statutes of 2013 (SB 28).

Department of Social Services

The Department of Social Services administers programs that provide services and assistance payments to 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, Child Welfare Services, Community Care Licensing, and Disability Determination.

Significant Adjustments:

- IHSS Caseload—An increase of $147.6 million General Fund in 2014-15 and $179.1 million General Fund in 2015-16 associated primarily with increases in caseload, hours per case, and costs per hour.
- CalWORKs Caseload—Decreased General Fund and federal Temporary Assistance for Needy Families block grant expenditures of $97 million in 2015-16 to reflect revised caseload projections since the Governor's Budget. Overall CalWORKs caseload continues to decline, as caseload is projected to be approximately 539,000 in 2014-15 and 525,000 in 2015-16.

Fair Labor Standards Act Rule

In January 2015, a federal court vacated the United States Department of Labor rule that required overtime pay for IHSS workers under the Fair Labor Standards Act. The federal government appealed this decision but in the interim, the state has halted implementation of the rule until the legality of the rule is determined. A final court decision is unlikely before the end of fiscal year 2014-15. If the rule is upheld, implementation could begin right away.

The Governor's Budget included $184 million General Fund in the Department of Social Services' budget for implementation in 2014-15 and $316 million in 2015-16. To date, none of the 2014-15 funds have been spent. Chapter 29, Statutes of 2014 (SB 855), includes a provision requiring any unspent FLSA-related funding in the current year resulting from delayed federal implementation of the rule be used for other purposes within the IHSS program. The May Revision uses these one-time unspent funds to partially offset the $326.7 million in increased IHSS costs described above. The May Revision continues to assume full-year funding in 2015-16 for implementation of the federal rule.

Department of Developmental Services

The Department of Developmental Services provides consumers with developmental disabilities a variety of services and supports that allow them to live and work independently, or in supported environments. The Department serves approximately 290,000 individuals with developmental disabilities in the community, and 1,035 individuals in state-operated developmental centers. The May Revision includes $5.9 billion ($3.5 billion General Fund) in 2015-16 for support of the Department and community services.

The Future of State Developmental Centers

The Plan for the Future of Developmental Centers in California, issued in January of 2014, recommended that in the future, the state should operate a limited number of smaller, safety-net crisis and residential services. Since then, portions of the Sonoma Developmental Center were found to be in violation of federal requirements and the state was notified that federal funds for those units would cease. The state is in the process of negotiating a settlement with the federal government to continue federal funding for Sonoma for a limited amount of time.

Consistent with the recommendations in the Plan for the Future of Developmental Centers in California, the May Revision proposes to initiate closure planning for the remaining developmental centers.

The Department will provide a closure timeline for the Sonoma Developmental Center with the goal of closing this developmental center by the end of 2018. As part of this closure process, the Department will convene stakeholders to discuss alternative uses for the Sonoma campus. The May Revision also proposes the future closure of the Fairview Developmental Center and the non-secure treatment portion of the Porterville Developmental Center, with the last closure completed in 2021. The closure of each developmental center will require significant resources to develop placement options and services for the developmental center residents who will transition into other placements.

Significant Adjustment:

- Transition of Sonoma Residents—In anticipation of the closure of the Sonoma Developmental Center, the May Revision includes $49.3 million ($46.9 million General Fund) to begin development of resources to support the transition of Sonoma residents. These resources will fund the initial development of homes to support consumers, provide additional training for providers, and develop additional programs such as supported living services, crisis services, and transportation support and services. This funding will also be used for coordination of the closure.

Department of State Hospitals

The Department of State Hospitals administers the state mental health hospital system, the Forensic Conditional Release Program, the Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed and voluntary patients. The May Revision includes $1.7 billion ($1.6 billion General Fund) in 2015-16 for support of the Department. The patient population is projected to reach a total of 7,165 in 2015-16.

Significant Adjustments:

- Restoration of Competency Expansion—The May Revision includes $10.1 million General Fund to expand the Restoration of Competency Program by up to 108 beds to address the existing placement waitlist. The program provides for treatment of certain Incompetent to Stand Trial patients in county jails rather than inpatient treatment at a state hospital. Treating these patients at the county jail is more cost-effective than inpatient treatment at a state hospital. This expansion should help reduce the waitlist for Incompetent to Stand Trial defendants. Including these new beds, the total number of Restoration of Competency beds is expected to be approximately 148 by the end of 2015-16.

- *Coleman* Housing—The May Revision includes $4.6 million General Fund to activate 30 beds at the California Medical Facility in Vacaville to add sufficient capacity for the Department to serve *Coleman* patients. The Special Master over the *Coleman* case has been critical of the waitlist for intermediate and acute beds within the psychiatric programs. There is a need to activate this unit and increase the inpatient capacity within the psychiatric programs to respond to changing patient needs.

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Public Safety

The May Revision includes the following changes related to public safety.

Corrections and Rehabilitation

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

The May Revision includes $10.2 billion ($9.9 billion General Fund and $283 million other funds) for CDCR in 2015-16.

CDCR's General Fund budget is $130 million less than the Governor's Budget (excluding a $60.6 million transfer from the statewide funding set aside for high-cost medications). As discussed below, the main component of these savings is a reduction of 4,000 out-of-state beds by the end of the year.

Prison Population Update and Future Planning

The Governor's Budget projected an overall adult inmate average daily population of 134,986 in 2014-15 and 133,109 in 2015-16. Due to measures reducing the population working faster than previously estimated, the average daily adult inmate population is now projected to decrease by 1.1 percent to 133,451 in 2014-15 and decrease by 3.8 percent to 127,990 in 2015-16 compared to the Governor's Budget projections, as displayed in Figure SAF-01.

Figure SAF-01
Spring 2015 Population Estimates

	2014-15	2015-16
Adult Average Daily Population Projection	133,558	129,581
Population Reduction Measures[1]	-107	-1,591
Total Average Daily Population Projection	**133,451**	**127,990**

[1]For the May Revision, the Population Reduction Measures include the new parole determination process for non-violent, non-sex registrant second-strike offenders and two-for-one credit earning for minimum custody inmates currently eligible for day-for-day credits. The impacts of all other court-ordered population reduction measures, and the effects of Proposition 47, are now incorporated in the Adult Average Daily Population Projection.

On February 10, 2014, the three-judge court granted the state's request for a two-year extension of the deadline to meet the 137.5-percent population cap and ordered the state to comply with interim benchmarks of 143 percent by June 30, 2014 (subsequently extended to August 31, 2014), 141.5 percent by February 28, 2015, and the final population cap by February 28, 2016. The prison population is currently below the final February 2016 benchmark by 2,220 inmates. However, 2015-16 presents extraordinary challenges and uncertainties for the state prison system.

The Governor's Budget assumed no reduction to the use of 9,000 out-of-state contract beds, and the fall projections assumed an average daily population reduction of 1,900 inmates in 2015-16 related to the Safe Neighborhoods and Schools Act (Proposition 47). Additionally, the Governor's Budget assumed the activation of three prison infill projects by February 2016, which would increase the institution capacity by 3,267. However, there continues to be risk associated with this assumption as the timeline assumes an aggressive construction schedule, and the state is required to meet and confer with plaintiffs regarding how the infill beds will be counted toward capacity.

Compared with the Governor's Budget, spring population projections show an average daily population reduction of approximately 5,100 inmates in 2015-16. This significant decline is driven primarily by revised Proposition 47 estimates showing that the measure is impacting the prison population sooner than expected in the Governor's Budget. Given the magnitude of the projected population decline, and the need to maintain sufficient capacity compared with the final population cap of 137.5 percent, the Administration has developed a revised contract bed plan for the May Revision that focuses on reducing the use of out-of-state contract beds.

The May Revision includes savings of $73.3 million General Fund in 2015-16 tied to the reduction of approximately 4,000 out-of-state contract beds by June 2016. The reduction assumes vacating two out-of-state facilities and reducing use of other out-of-state facilities to achieve a 2,700-bed reduction by December 2015 and a further 1,300-bed reduction by June 2016.

Further reductions to the use of out-of-state beds beyond 4,000 in 2015-16 could jeopardize ongoing compliance with the 137.5-percent population cap, as the total inmate population is projected to increase in 2016-17 and ongoing. Based on this planned reduction and current population trends, by early 2017-18, CDCR's inmate population could be above the targeted capacity and impact compliance with the court-ordered population cap. Moreover, since multiple population reduction measures are in early implementation stages, there is significant uncertainty with the overall population trends. For example, the population projections assume an average daily population reduction of approximately 1,300 inmates in 2015-16 resulting from the new parole determination process for non-violent second-strikers, and a reduction of another 4,600 inmates due to the impacts of Proposition 47.

Recognizing the extraordinary uncertainties within the current population trends, the Administration will develop for the 2016-17 Governor's Budget a long-term plan which, among other issues, takes into account:

- CDCR's growing population trends, housing limitations, and rehabilitation goals;
- any use of contract beds on an ongoing basis, including in-state contract beds, out-of-state contract beds, and the leasing of the California City correctional facility;
- a permanent solution for the decaying infrastructure of the California Rehabilitation Center;
- the need for durable population reductions to stay below 137.5 percent of design capacity, such as the current, court-ordered population reduction measures; and
- the impact of population-reduction measures on fire camps.

Significant Adjustments:

- Adult Population Adjustment—A decrease of $21.3 million General Fund in 2014-15 and $108.5 million General Fund in 2015-16 for adult inmate and parole population changes. The revised average daily population projections for adult inmates are 133,451 in the current year and 127,990 in the budget year, a decrease of 1,535 and 5,119 inmates, respectively. The revised average daily parolee population projection is 44,073 in the current year and 44,570 in the budget year, an increase of 847 and 4,103 parolees, respectively.
- Juvenile Population Adjustment—A decrease of $494,000 General Fund in 2014-15 and $2 million General Fund in 2015-16 for juvenile population adjustments. The revised average daily population projections for wards are 683 in the current year and 677 in the budget year, which is a decrease of 2 wards in the current year and 32 wards in the budget year.
- Hepatitis C Treatment—An increase of $51.8 million General Fund in 2014-15 and $60.6 million General Fund in 2015-16 to treat inmates with new Hepatitis C treatments. At the Governor's Budget, this funding was carried in the statewide set-aside for high-cost medications pending coordination of a working group on a statewide approach to high-cost medications. The May Revision allocates increases to the affected budgets.

Community Corrections Performance Incentive Grant

The Community Corrections Performance Incentive Grant, Chapter 608, Statutes of 2009 (SB 678), was created to provide incentives for counties to reduce the number of felony probationers sent to state prison. This performance-based funding has been provided to county probation departments when they successfully reduce the number of adult felony probationers going to state prison. The May Revision proposes to update the SB 678 funding formula to include all types of local felony supervision, refocus this grant on local supervision admissions to state prison, and reward counties' past success. The intent of this revision is to preserve past successes and encourage county probation departments to continue to decrease the number of individuals sent to state prison. With the revision of this formula, the May Revision proposes to augment this grant program by $1.1 million for a total of $125.8 million in 2015-16.

County probation departments oversee three types of local felony supervision: probation, Mandatory Supervision and Post Release Community Supervision. Felons on probation that have committed a prison-eligible crime can be admitted to state prison under two circumstances: (1) their probation is revoked for a technical violation of the terms of their probation or (2) they commit a new prison-eligible crime. Felons on Mandatory Supervision and Post Release Community Supervision can be sentenced to state prison only if they commit a new prison-eligible crime. In 2014, 10 percent of all state prison admissions were due to technical violations of probation, while 18 percent of all state prison admissions were due to new prison-eligible crimes committed by felons on local supervision.

The proposed formula will provide incentive funding to counties that decrease their state prison admissions below a 2013 baseline. Reductions in state prison admissions for new crimes for individuals on felony probation, Mandatory Supervision and Post Release Community Supervision will be funded at 50 percent of the state's estimated contract bed rate per offender, while reductions in state prison admissions for technical revocations by felony probationers will be funded at 75 percent of the state's estimated contract bed rate per offender. Additionally, counties with a state prison admission rate 50 percent below the state average will receive a high-performance grant. The focus on technical revocations provides incentives to keep felons on probation in programs and out of state prison. Lastly, the formula adds a past performance allocation for counties which is equal to 60 percent of the average of the highest two years of past payments. Providing an element of stable funding will allow counties to continue programs that produced this past success, while also allowing counties to commit funding to ongoing strategies to continue to reduce their admissions to state prison.

The funding from the SB 678 grant program over the past four years has been an important component to reducing the state prison population. While California's criminal justice system is still undergoing systemic changes, preserving proven population reduction programs like SB 678 is key to a durable solution for the state to maintain compliance with the court-ordered population cap of 137.5 percent of design capacity.

Amnesty Program

The Governor's Budget included an 18-month amnesty program that authorizes individuals with past due court-ordered debt owed prior to January 1, 2013, relating to traffic infractions, to pay outstanding delinquent debt at a 50-percent reduction if the individual meets specified eligibility criteria. Overall, the amnesty program is estimated to generate $150 million, which will help avoid structural deficits within many of the eight special funds supported by the State Penalty Fund. Approximately $12 million of the $150 million is expected to be deposited in the State Penalty Fund.

The May Revision updates the Administration's proposed amnesty program by allowing individuals whose driver licenses have been suspended due to Failure To Appear or Failure To Pay related to traffic offenses to reinstate their licenses as part of the program—so they can legally get to work and make their agreed upon payments to the Court. These individuals would agree to either make one payment or sign up for a payment plan, supported by a wage garnishment agreement in the event that the individual fails to make a payment. In addition, the $300 court-imposed assessment fee pursuant to the Penal Code will be waived for the purposes of the amnesty program and replaced by a $50 amnesty administrative fee for the courts to recover their costs of running the program.

Commission on Peace Officer Standards and Training

The Commission on Peace Officer Standards and Training's main funding source is the Peace Officers' Training Fund, which receives the majority of its revenue from the State Penalty Fund. The Commission's budget can be categorized into three main areas: administration, contracts for training courses, and reimbursement of training costs. In January 2014, due to declining revenues, the Commission instituted an 18-month reduction plan that relied heavily on reducing the reimbursement of training costs provided to local law enforcement agencies that attend training. The limited-term reduction plan also includes smaller reductions to training course contracts, as well as some workshops and seminars conducted by the Commission.

Because the Commission's reduction plan was limited term and revenues from the State Penalty Fund continued to decline, the Governor's Budget included a reduction of $5.2 million to the Commission's administrative costs. This reduction, coupled with the proposed delinquent-debt amnesty program, was a placeholder to cover a revenue shortfall in the Peace Officers' Training Fund in 2015-16.

The May Revision refines the proposal by reducing administrative costs ($800,000); slightly increasing the current reduction of contracted, non-mandated training courses ($1.9 million); and continuing the suspension of reimbursements for local law enforcement to backfill behind officers participating in training ($2.5 million). The proposed reduction should not further impact the current training services offered, as it is a continuation of existing reductions or reduced level of services. The proposed reduction, coupled with the delinquent-debt amnesty program, will allow the Commission to reinstate reimbursement of travel and per diem costs of approximately $4.4 million—a reimbursement that has been suspended since January 2014—which will help reduce the cost of training for local law enforcement agencies.

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Emergency Drought Response

The State of California has experienced four consecutive years of below-average rain and snow, and is currently facing severe drought conditions in all 58 counties. The most recent surveys recorded the statewide average snowpack, which is the source for one-third of the state's water, at just 2 percent of the normal average. Water supplies at the state's largest reservoirs, as well as groundwater aquifers, are significantly depleted. As a result, drinking water supplies are at risk in some communities, agricultural areas face increased unemployment, dry conditions create higher risks for wildfires, and important environmental habitats have already been degraded.

The state's emergency drought response is strategically guided by accelerating several of the key actions in the California Water Action Plan that will provide long-term benefits for the state.

$1.9 billion for Drought Relief and Water Infrastructure

Since the Governor first declared a state of emergency in January 2014, the Administration has worked with the Legislature to appropriate approximately $1.9 billion to assist drought-impacted communities and provide additional resources for critical water infrastructure projects, including:

- $660 million Proposition 1E bond funds for the Department of Water Resources (DWR) to support flood protection in urban and rural areas and to make the state's infrastructure more resilient to climate change and flood events.
- $472.5 million Proposition 84 bond funds for the DWR to provide infrastructure grants for local and regional projects that increase local water supply reliability by recapturing stormwater, expanding the use and distribution of recycled water, enhancing the management and recharge of groundwater storage, and strengthening water conservation efforts.
- $268 million Proposition 1 bond funds, recently approved by the voters in 2014, for the State Water Resources Control Board (Water Board) to provide grants for safe drinking water and water recycling projects.
- $53.8 million General Fund for the Department of Forestry and Fire Protection to enhance the state's firefighter surge capacity, retain seasonal firefighters beyond the budgeted fire season, and enhance air attack capabilities to suppress wildfires.
- $50 million Cap and Trade funds for the DWR to support state and local water use efficiency projects that save energy and reduce greenhouse gas emissions.
- $47.3 million General Fund for the Department of Social Services to provide food assistance to those impacted by the drought.
- $35 million General Fund and special funds for the Water Board to provide grants for emergency drinking water projects.
- $20 million Cap and Trade funds for the California Department of Food and Agriculture to invest in irrigation and water pumping systems that reduce water use, energy use, and greenhouse gas emissions.

Governor's Recent Executive Order

On April 1, 2015, for the first time in state history, the Governor ordered statewide mandatory water reductions. Specifically, Executive Order B-29-15 directs the Water Board to reduce potable urban water use by 25 percent statewide. The Water Board adopted a regulation in early May which is equitable, achievable, and enforceable for every urban water supplier, and is designed to be implemented quickly to maximize water conservation during the upcoming summer months.

In addition, the Executive Order identifies actions to save water, increase enforcement to prevent wasteful water use, streamline the state's drought response and invest in new technologies that will make California more drought resilient. Specifically, the Executive Order does the following:

- Simplifies the review and approval process for voluntary water transfers and emergency drinking water projects.
- Prioritizes state review and decision-making of new water infrastructure projects.
- Requires agricultural water users to report more water use information, increasing the state's ability to enforce against illegal diversions, waste and unreasonable use of water.
- Requires landscapes for new homes and developments to be highly water efficient, and bans watering of ornamental grass on public street medians.
- Encourages local water agencies to adjust their rate structures to implement conservation pricing, recognized as an effective way to realize water reductions and discourage water waste.

The Executive Order is the fifth order that the Governor has issued since January 2014 to direct emergency drought response.

Emergency Salinity Barrier in the Delta

Faced with potentially insufficient water supplies to prevent salinity intrusion into the Sacramento-San Joaquin Delta, the DWR, in consultation with federal and state water and wildlife agencies, has initiated installation of an emergency, temporary rock barrier across West False River in the Delta. The temporary barrier will physically slow the tidal push of saltwater from the San Francisco Bay into the central Delta and help prevent contamination of water quality for municipal, industrial, agricultural and environmental needs. The barrier will also help preserve freshwater in upstream reservoirs that otherwise would have to be released to repel saltwater.

The barrier will help prevent saltwater contamination of water supplies for the people who live in the Delta; Contra Costa, Alameda, and Santa Clara counties; as well as the 25 million people and three million acres of irrigated agriculture that depend upon the Delta-based federal and state water projects for some of their water supplies.

This barrier must be removed in November to avoid the flood season and prevent harm to migratory fish. The May Revision includes $22 million General Fund for the removal of the temporary barriers.

Additional Proposed Budget Actions

The May Revision includes an additional $2.2 billion of one-time resources for 2015-16 to continue immediate response to drought impacts. This additional funding is proposed in the wake of a very dry winter as the state continues to suffer from a drought of uncertain duration. The acceleration of spending from Proposition 1—combined with new dollars from the General Fund and Cap and Trade—reflects the Administration's commitment to move quickly in responding to the drought. The state must remain nimble in addressing the state of emergency. Funds should be spent as expeditiously as possible, while recognizing that in some cases grant recipients need sufficient time to develop appropriate plans and local matches for the state funds. Figure DRT-01 summarizes this funding.

Protecting and Expanding Local Water Supplies

In November 2014, the voters approved Proposition 1, which provides $7.5 billion in bonds for water storage, water quality, flood protection, and watershed protection and restoration projects. In an effort to accelerate the implementation of water infrastructure projects statewide, the May Revision includes $1.8 billion Proposition 1 funds for the following programs:

- $1.7 billion, available over the next three years, for the following Water Board programs:
    - Groundwater Contamination—$784 million for projects that prevent or clean up the contamination of groundwater that serves as a source of drinking water.
    - Water Recycling—$475 million for water recycling and advanced treatment projects to enhance local water supply resiliency.
    - Safe Drinking Water—$180 million for projects, with priority given to small systems in disadvantaged communities, which help to provide clean, safe and reliable drinking water.
    - Wastewater Treatment Projects—$160 million for small communities to build or upgrade their wastewater systems to meet current standards.

Figure DRT-01

Emergency Drought Response

(Dollars in Millions)

Investment Category	*Department*	*Program*	*May Revision*	*Fund Source*
Protecting and Expanding Local Water Supplies	Water Board	Groundwater Contamination	$784.0	Proposition 1
	Water Board	Water Recycling	$475.0	Proposition 1
	Water Board	Safe Drinking Water in Disadvantaged Communities	$180.0	Proposition 1
	Water Board	Wastewater Treatment Projects	$160.0	Proposition 1
	Water Board	Stormwater Management	$100.0	Proposition 1
	Department of Water Resources*	Groundwater Sustainability	$60.0	Proposition 1
	Department of Water Resources*	Desalination Projects	$50.0	Proposition 1
Water Conservation	Department of Water Resources*/Energy Commission	Urban Water Conservation	$104.0	Proposition 1/ Cap and Trade
	Department of Water Resources*/Department of Food and Agriculture	Agricultural Water Conservation	$75.0	Proposition 1/ Cap and Trade
	Department of Water Resources/Energy Commission	Make Water Conservation a Way of Life	$43.0	Proposition 1/ Cap and Trade
	Department of General Services	Water Conservation at State Facilities	$23.4	General Fund/ Special Funds
Emergency Response	Department of Forestry and Fire Protection**	Enhanced Fire Protection	$61.8	General Fund
	Office of Emergency Services	California Disaster Assistance Act	$22.2	General Fund
	Department of Water Resources	Removal of Emergency Salinity Barriers in the Delta	$22.0	General Fund
	Department of Community Services and Development	Farmworker Assistance	$7.5	General Fund
	Department of Housing and Community Development	Rental Relocation Assistance	$6.0	General Fund
	Water Board	Executive Order Implementation	$1.4	General Fund
Total			**$2,175**	

* Amounts include funding proposed in Governor's Budget and additional funding in May Revision.

** Proposed in the Governor's Budget

    - Stormwater Management—$100 million for multi-benefit stormwater management projects that also contribute to local water supplies.

- $110 million for the following DWR programs:

    - Groundwater Sustainability—$60 million to support local groundwater planning efforts. Of this amount, $50 million is available over the next three years for technical and direct assistance and grants to local agencies for groundwater sustainability governance and planning. An additional $10 million in immediate funding will be dedicated to counties with stressed groundwater basins to update or develop local ordinances and plans that protect basins and their beneficial users and help facilitate basin-wide sustainable groundwater management under the Sustainable Groundwater Management Act, in coordination with other local water managers.

    - Desalination Projects—$50 million, available over the next two years, to assist local agencies to develop new local water supplies through the construction of brackish water and ocean water desalination projects.

Water Conservation

The May Revision includes $245 million to fund programs and projects that save water, including:

- $104 million for the following urban water conservation programs:

    - $43 million ($30 million Cap and Trade funds for the Energy Commission and $13 million Proposition 1 funds for DWR) to implement consumer rebate programs for the replacement of inefficient water consuming appliances, including dishwashers and toilets, to save water and energy and reduce greenhouse gas emissions, consistent with the April 1 Executive Order.

    - $27 million Proposition 1 funds to replace lawns in underserved communities throughout the state with water efficient landscaping, consistent with the April 1 Executive Order.

    - $20 million Cap and Trade funds for the DWR Water Energy Grant Program to reduce energy demand and greenhouse gas emissions through local projects that also support water use efficiency and conservation.

- $10 million Proposition 1 funds to implement the CalConserve Program, which will enable homeowners and businesses to finance water-efficiency upgrades through a revolving-loan program.
- $4 million General Fund to augment the Save Our Water campaign to target the state's largest residential water users with focused information to reduce their water usage.

- $75 million ($40 million Cap and Trade funds and $35 million Proposition 1 funds) for agricultural water efficiency programs. These additional resources will enable the Department of Food and Agriculture and DWR to provide incentives to agricultural operations to invest in water irrigation technologies that reduce water and energy use, and greenhouse gas emissions. To facilitate implementation of the agricultural water conservation measures, the Public Utilities Commission will create a process to resolve interconnection disputes and allow distributed generation projects that save water and energy to move forward more quickly.
- $43 million for activities that will integrate water conservation into residents' lifestyles, consistent with the Water Action Plan, including:
  - $30 million Cap and Trade funds to begin implementation of the Water Energy Technology Program, consistent with April 1 Executive Order, to provide funding for innovative technologies that (1) display significant water and energy savings, which also reduce greenhouse gas emissions, (2) demonstrate actual operation beyond the research and development stage, and (3) document readiness for rapid, large scale deployment in California.
  - $13 million Proposition 1 funds for the DWR to provide technical assistance, data collection, and applied research that supports long-term water use efficiency in urban and agricultural sectors.
- $23 million, including $10 million General Fund, for water conservation projects at state facilities. As urban and agricultural water users across the state are reducing their water use, it is critical that state facilities continue to reduce water use. This proposal will provide additional funds to implement indoor and outdoor water conservation measures at state facilities.

Emergency Response

The May Revision includes $37.1 million General Fund to assist drought-impacted communities and enforce water use restrictions, including:

- $22.2 million General Fund for the Office of Emergency Services to support local jurisdictions using the California Disaster Assistance Act program for approved drought-related projects, including, but not limited to, restoring and replacing public infrastructure that sustained drought-related damages, and emergency protective measures such as delivering water to individuals without drinking or potable water.
- $7.5 million General Fund for the Department of Community Services Development to provide emergency assistance to unemployed farmworkers, including job training and assistance.
- $6 million General Fund for the Department of Housing and Community Development to assist or relocate households without potable water sources due to drought.
- $1.4 million General Fund for the Water Board to increase enforcement of water use restrictions and conduct additional inspections of diversion facilities to verify compliance with water rights laws.

Additional Local Enforcement Authority

The May Revision proposes legislation to enhance local enforcement authority by providing all water agencies and local governments a consistent, minimum set of enforcement authorities to achieve required water conservation. Local water agencies with existing authorities to enforce against water waste can continue to use those authorities. Under this proposed legislation, any monetary penalties from this enforcement will be used for local conservation efforts. Specifically, it allows penalties to be issued administratively by wholesale and retail water agencies, as well as city and county governments, and enables these entities to enforce local water waste restrictions and Water Board conservation restrictions.

Cap and Trade Expenditure Plan

The California Global Warming Solutions Act of 2006 (AB 32) established California as a global leader in reducing greenhouse gas emissions (GHGs). To meet the goals of AB 32, the state has adopted a three-pronged approach to reducing emissions: adopting standards and regulations, providing emission reduction incentives via grant programs, and establishing a market-based compliance mechanism known as Cap and Trade. The Cap and Trade program sets a statewide limit on the GHG sources responsible for 85 percent of California GHGs. Through an auction, it establishes a financial incentive for industries subject to the statewide cap to make long-term investments in cleaner fuels, more efficient energy use, and transformational technological and scientific innovations. The Cap and Trade program provides GHG emitters the flexibility to implement the most efficient options to reduce GHGs. Based on the first update to the Climate Change Scoping Plan, the Cap and Trade program will be responsible for approximately 30 percent of the required GHG reductions to meet the AB 32 goal of reducing GHGs to 1990 levels by 2020. A portion of the auction proceeds generated from the sale of allowances are available to the state for expenditure.

2030 Greenhouse Gas Emission Reduction Goal

California is already experiencing impacts from climate change, such as more severe wildfires, a longer fire season, more extreme heat days, and sea-level rise. The state is also facing the fourth year of prolonged and serious drought conditions made worse by the effects of climate change. California's residents, especially those in areas disproportionately affected by changes in the environment, contend with higher average temperatures exacerbated by urban heat islands, smoke from wildfires, and diminishing water supply.

Understanding California's role in reducing GHGs to mitigate climate change and protecting the state's residents and economy from a changing climate, the Governor issued Executive Order B-30-15 establishing a GHG reduction target of 40 percent below 1990 levels by 2030. Along with this target — the most ambitious in North America — the Governor also required state agencies to incorporate climate resiliency into planning and funding decisions to protect the State's resources from California's changing climate. To meet the GHG reduction target specified in the Executive Order, the Administration is pursuing policies that by 2030:

- Increase electricity derived from renewable resources to 50 percent.
- Reduce petroleum use in cars and trucks by up to 50 percent.
- Double energy efficiency achieved at existing buildings, and make heating fuels cleaner.
- Reduce the release of short-lived climate pollutants, such as methane and black carbon.
- Increase carbon sequestration on farms and rangelands, and in forests and wetlands.

The May Revision supports the Governor's 2030 GHG reduction target by including a $2.2 billion Cap and Trade Expenditure Plan that will further reduce emissions by providing additional resources for clean transportation and mass transit, energy efficiency and renewable energy, waste reduction, and ecosystem restoration programs. (see Figure CAP-01). Each administering agency will utilize a public process to engage stakeholders in the development and implementation of the programs. The increased resources in the plan reflect a revised auction proceed estimate, as well as the establishment of a prudent reserve to account for potential volatility in future auction proceeds.

Specifically, the increased proceeds result in a total of $1.6 billion for clean transportation, mass transit and sustainable community development. These resources will provide a significant investment towards meeting the 2030 goals. See the Transportation chapter for more detail.

Figure CAP-01
2015-16 Cap and Trade Expenditure Plan
(Dollars in Millions)

Investment Category	*Department*	*Program*	*Jan 10/ Accelerated Drought*	*May Revision*	*Total*
Sustainable Communities and Clean Transportation	High-Speed Rail Authority	High-Speed Rail Project	$250	$250	$500
	State Transit Assistance	Low Carbon Transit Operations Program	$50	$50	$100
	Transportation Agency	Transit and Intercity Rail Capital Program	$100	$165	$265
	Strategic Growth Council	Affordable Housing and Sustainable Communities Program	$200	$200	$400
	Air Resources Board	Low Carbon Transportation	$200	$150	$350
Energy Efficiency and Clean Energy	Department of Community Services and Development	Energy Efficiency Upgrades/Weatherization	$75	$65	$140
	Department of General Services *	Energy Efficiency for Public Buildings	$20	$20	$40
	University of California/ California State University	Renewable Energy and Energy Efficiency Projects	$0	$60	$60
	Department of Water Resources/Department of Food and Agriculture	Water and Energy Efficiency	($30)	$60	$60
	Energy Commission/ Department of Water Resources	Drought Executive Order - Rebates for Appliances	$0	$30	$30
	Energy Commission/ Department of Water Resources	Drought Executive Order - Water and Energy Technology Program	$0	$30	$30
	Department of Food and Agriculture	Agricultural Energy and Operational Efficiency	$5	$20	$25
Natural Resources and Waste Diversion	Department of Fish and Wildlife	Wetlands and Watershed Restoration	$25	$40	$65
	Department of Forestry and Fire Protection	Forest Health	$42	$50	$92
	Department of Food and Agriculture	Healthy Soils	$0	$20	$20
	Cal Recycle	Waste Diversion	$25	$35	$60
Total			**$992**	**$1,245**	**$2,237**

* Shifts administration of Green Buildings and $20 million from the current year from Energy Commission to Department of General Services.

The Expenditure Plan is consistent with the 2013 Cap and Trade Auction Proceeds Investment Plan and Chapter 830, Statutes of 2012 (SB 535). Through investment in the programs identified in the Expenditure Plan, the state will meet the SB 535 disadvantaged community targets. The May Revision also includes additional resources to expand the assistance available to disadvantaged communities to increase program awareness, access to funding, and participation.

In addition to reducing GHGs, the programs and projects funded by the Cap and Trade Expenditure Plan also support the following several other priority statewide initiatives.

Energy and Water Conservation in the Fourth Year of the Statewide Drought

California is experiencing the fourth consecutive year of below-average rain and snow, and is currently facing severe drought conditions statewide. Water levels in the state's reservoirs are depleted, the state's rivers are experiencing reduced flows, and recent surveys have recorded Sierra Nevada snowpack at record lows. For additional information on drought-related expenditures, see the Emergency Drought Response chapter.

The Cap and Trade Expenditure Plan includes an additional $128 million for the following programs that will reduce GHGs by saving energy through water conservation:

- $40 million for the California Department of Food and Agriculture's existing State Water Efficiency and Enhancement Program to provide incentives to agricultural operations to invest in energy-efficient irrigation technologies that reduce water use.
- $30 million for the Energy Commission to begin implementation of the Water Energy Technology Program to provide funding for innovative technologies that (1) display significant energy and water savings, (2) demonstrate actual operation beyond the research and development stage, and (3) document readiness for rapid, large-scale deployment in California.
- $30 million for the Energy Commission to implement a consumer rebate program for the replacement of energy-inefficient water-consuming appliances, such as dishwashers and washing machines.
- $20 million for the Department of Water Resources' existing Water Energy Grant Program to reduce energy demand and GHGs through local projects that also support water use efficiency and conservation.
- $8 million for the Department of General Services for projects that will reduce energy use through water conservation at state prisons located in the Central Valley.

Wetland Carbon Sequestration — Water Action Plan and California EcoRestore

The Water Action Plan, a comprehensive five-year water infrastructure and management strategy to support sustainable water management, includes actions to protect and restore important ecosystems. The Water Action Plan identified several specific action items to achieve the co-equal goals of water supply reliability and ecosystem restoration for the Delta, including the implementation of near-term Delta improvement projects. The Administration is implementing the California EcoRestore program to accelerate habitat restoration projects that support the long-term health of the Delta's native fish and wildlife species. Specifically, Cal EcoRestore will protect and restore at least 30,000 acres of wetlands, tidal habitat and floodplains; improve fish passage in the Yolo Bypass; and prioritize restoration projects supported by local communities.

In addition to these ecosystem benefits, wetland protection and restoration increases carbon sequestration. The Cap and Trade Expenditure Plan supports these Cal EcoRestore restoration efforts identified in the Water Action Plan with an additional $40 million for Delta wetland restoration projects.

Energy Efficiency in Higher Education

The state's universities are working towards reducing GHGs at all campuses. Toward that end, the Cap and Trade Expenditure Plan provides $35 million to the California State University system and $25 million to the University of California. This $60 million will fund renewable energy and energy efficiency projects throughout both systems.

Carbon-Rich Healthy Soils Initiative

As the leading agricultural state in the nation, it is important for California's soils to be sustainable and resilient to climate change. Increased carbon in soils is responsible for numerous benefits including increased water holding capacity, increased crop yields and decreased sediment erosion. The Cap and Trade Expenditure Plan includes $20 million to support demonstration projects that increase carbon in soil.

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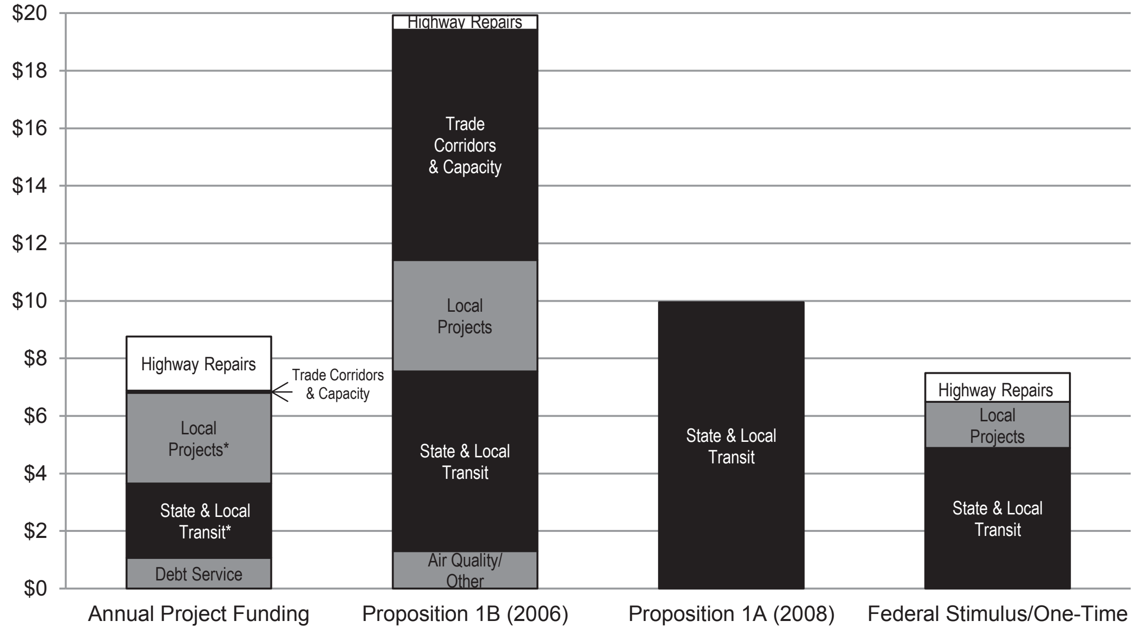
Transportation

The Transportation Agency is responsible for developing and coordinating the policies and programs of the state's transportation entities to improve the mobility, safety, and environmental sustainability of California's transportation system.

The Department of Transportation (Caltrans) designs and oversees the construction of state highways, operates and maintains the highway system, funds three intercity passenger rail routes, and provides funding for local transportation projects. Caltrans maintains 50,000 highway lane miles and nearly 13,000 state-owned bridges, and inspects more than 400 public-use and special-use airports and heliports. California continues to face considerable challenges in its ability to fund critical maintenance and repair of its core transportation infrastructure—state highways, local roads, and bridges.

During the last decade, transportation investments were directed primarily to decreasing traffic congestion, expediting goods movement, funding local streets and roads projects, and increasing transit facilities (see Figure TRN-01). Although the repair, maintenance, and efficient operation of the state's highway system is vital to California's continued economic growth, these aspects have largely been overlooked and current resources do not provide enough funding to support annual maintenance and repair needs of this vast system. Of the $8 billion in annual highway repair needs, the current fuel excise tax revenues are only sufficient to fund $2.3 billion, leaving $5.7 billion in unfunded repairs each year based on the latest estimate of the state's deferred maintenance.

Figure TRN-01
Allocation of State Transportation Project Funding
(Dollars in Billions)



*Does not include $3.8 billion in local sales tax measure revenues.

Efforts at converting California vehicles to sustainable fuel sources, and making vehicles more fuel-efficient, have continued to reduce greenhouse gas emissions. However, one consequence of this success is lower long-term fuel excise tax revenues—the state's primary source of funding for the maintenance and repair of its transportation infrastructure. While the state is accelerating the pilot program to explore a potential mileage-based revenue collection system, or Road Usage Charge, implementation of a broader statewide program is not likely for a number of years.

The California Transportation Infrastructure Priorities workgroup, convened by the Transportation Agency, continues to meet to prioritize transportation investments and explore pay-as-you go funding alternatives to address the state's infrastructure needs. The Administration is also working with the Legislature on its proposals in an effort to develop a funding package by year end.

In considering new funding sources, the state must focus on the priorities that are the state's core responsibility—maintaining and operating the state's network of highways and interstates, and improving the highest priority freight corridors. Funding should come from pay-as-you-go transportation user fees, and be sustainable as gasoline consumption falls. Any solution for addressing the long-term needs of the state's highway system must reflect the state's economic development and environmental objectives, focus on repair and maintenance, invest in trade corridors, and complement local efforts that generate revenues for roads. Any new funding generated should also have performance objectives measured by the percentage of pavement, bridges, and culverts in good condition.

Though ongoing funding for roads and highways has not increased substantially in recent years, Cap and Trade proceeds provided for a significant investment in clean transportation and mass transit beginning in 2014-15. The Cap and Trade funding plan also provides an ongoing share of annual revenues—setting aside a total of 60 percent for public transportation, active transportation, and housing. The May Revision provides a total of $1.6 billion for public transit, high-speed rail, and sustainable community development in 2015-16 as follows:

- Transit Operations—$100 million for transit operations in the Low Carbon Transit Operations Program.
- Transit Capital—$265 million for rail and transit in the Transit and Intercity Rail Capital Program.
- Affordable Housing, Transit, and Active Transportation—$400 million for projects in the Affordable Housing and Sustainable Communities Program.
- High-Speed Rail—$500 million for California's high-speed rail system.
- Low Carbon Transportation—$350 million for Air Resources Board clean transportation programs.

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Environmental Protection

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

The May Revision includes total funding of $4.7 billion ($72.9 million General Fund) for all programs included in the Agency.

State Water Resources Control Board

The State Water Resources Control Board and the nine Regional Water Quality Control Boards preserve and enhance the quality of California water resources, and protect the proper allocation and effective use of state water.

Significant Adjustment:

- Bay Delta Water Quality Control Plan—An increase of $7.8 million ($3.7 million General Fund and $4.1 Water Rights Fund) and 16 positions to complete the comprehensive update of the Bay Delta Water Quality Control Plan. The Water Action Plan, a comprehensive five-year water infrastructure and management strategy to support sustainable water management, identified the update of the Bay Delta Water Quality Control Plan. This proposal will develop flow criteria and an adaptive management framework that identifies water quality objectives needed to protect and balance competing uses of water, including municipal and agricultural supply, hydropower, fishery protection, and recreational uses.

Department of Toxic Substances Control

The Department of Toxic Substances Control protects California residents and the environment from the harmful effects of toxic substances by restoring contaminated properties, enforcing hazardous waste laws, reducing hazardous waste generation, and encouraging the manufacture of chemically-safer products.

The Department continues to make progress in implementing reforms initiated in its "Fixing the Foundation" initiative, which is designed to improve the efficiency and effectiveness of cleanup, permitting, enforcement, and safer consumer products programs. A key component of this effort is to enforce compliance with California's hazardous waste laws to prevent harm to public health and the environment, particularly in disproportionally impacted communities. The May Revision proposes additional resources to improve the Department's hazardous waste enforcement efforts.

Significant Adjustments:

- Improving Hazardous Waste Enforcement Program Performance—An increase of $1.4 million Toxic Substances Control Account annually for two years to improve the efficiency and effectiveness of the hazardous waste enforcement program and conduct a statewide community assessment.
- Enhanced Enforcement Initiative—An increase of $2.1 million from various special funds annually for three years to implement and evaluate approaches to address serious environmental violations that occur in California's most disproportionally impacted communities. This proposal will focus inspection and enforcement resources on metal recycling and hazardous waste transportation activities.

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 $8.7 billion ($2.5 billion General Fund) for all programs included in this Agency.

California Conservation Corps

The California Conservation Corps was established in 1976 by Governor Brown to provide young women and men the opportunity to work on conservation projects and respond to natural disasters. The Corps builds trails, plants trees, and implements clean energy and water conservation projects. The Corps currently serves approximately 1,622 members, including over 500 who live in residential facilities.

Significant Adjustments:

- Forest Health Improvement Projects—The Department of Forestry and Fire Protection (CALFIRE) will partner with the Corps on forest health projects that will be targeted in the highest fire risk areas of the state. These months-long projects will include tent camps near the project areas. Funding is provided in the CALFIRE budget and approximately $5 million of work will be allocated to the Corps as projects are identified.

- Butte County Conservation Camp—An increase of $3.1 million General Fund for CALFIRE to make necessary repairs to the Butte County fire camp that was closed in 2004. Partnering with CALFIRE, the Corps will open the Butte County Conservation Camp as a fire camp similar to the Camarillo Camp in Southern California. This will give the corpsmembers training in fire suppression and provide important fire protection resources in Northern California. It is expected that this camp will not be available until mid-2016.
- Long-Term Expansion—An increase of $200,000 General Fund to begin a process of identifying sites for additional residential centers. The Corps will work with the Department of General Services to examine sites on existing state property to determine the feasibility of either reopening old facilities or building new ones.

Salton Sea Restoration

The Salton Sea is one of the most important migratory bird flyways in North America and is threatened with reduced inflows and increased salinity. The Water Action Plan identified the protection of key habitat of the Salton Sea as a priority action.

California faces significant air quality and natural resources threats with the shrinking of the Salton Sea. Prior comprehensive plans to restore the sea are no longer feasible due to cost and decreased water availability resulting from the drought in California and in the southwestern states. The Administration is pursuing a phased strategy to restore the Salton Sea. Working with partners and utilizing existing funds already appropriated, the construction of over 1,000 acres of habitat and dust abatement projects is scheduled to begin in 2015. In addition, the Administration has formed the Salton Sea Task Force with principals from the Natural Resources and Environmental Protection Agencies to develop new achievable medium and long-term restoration plans. The Task Force will develop these plans in coordination with stakeholders, and will be appointing a new position using existing resources to lead the work of the Task Force and manage expedited construction of projects that protect both wildlife habitat and air quality at the sea.

Local Government

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

Redevelopment Agencies

Since the dissolution of Redevelopment Agencies (RDAs) in 2011-12, $4.2 billion in general purpose property tax revenue has been returned to cities, counties, and special districts. These funds are available to these local governments for core public services. Since 2011-12, K-14 schools have received over $4.3 billion in additional property tax revenue. This has generated a roughly commensurate amount of Proposition 98 General Fund savings for the state. Through 2018-19, annual General Fund savings of over $1 billion are anticipated, and these amounts will grow steadily over the next three decades as the former RDAs' debts are steadily repaid and property taxes in RDA project areas grow.

As part of the Governor's Budget, the Administration introduced trailer bill language to simplify the current RDA dissolution process by (1) providing a pathway for permanent dissolution with limited state oversight, (2) clarifying and refining various provisions of the dissolution statutes where there has been perceived ambiguity (thereby making them operate more successfully for all parties without rewarding prior questionable behavior), and (3) minimizing the erosion of property tax residuals being returned to affected local taxing entities.

Over the past several months, the Department of Finance has met with many local government entities to discuss the proposed legislation. Discussions focused on how the legislation could be amended to meet the needs of the cities and counties that formerly operated RDAs (the sponsoring entities), while maintaining the continued orderly and expeditious wind-down of the former RDAs and minimizing the fiscal impact on the state and other affected taxing entities.

Taking into consideration input from stakeholders, the May Revision includes the following substantive amendments to the proposed RDA dissolution legislation:

- Findings of Completion—Findings of completion provide successor agencies with increased fiscal tools and reduced state oversight. The May Revision allows successor agencies that enter into a written payment agreement with Finance to remit their unencumbered RDA cash assets to the county auditor-controller to receive a finding of completion.
- Stranded 2011 Bond Proceeds—For successor agencies with a finding of completion, the May Revision establishes a tiered process whereby they may expend a portion of these stranded proceeds. The unused portions are to be used to defease the outstanding bonds in accordance with current law.
- Property Tax "Override" Revenues—The May Revision clarifies that any pension or State Water Project override revenues pledged to RDA debt service must be used for that purpose. However, if the override revenues were not pledged to debt service, they will be returned in their entirety to the entity that levies the override. Furthermore, if the override revenues were pledged to RDA debt service, but some of the revenues are not needed for debt service payments, the entirety of the portion not needed for debt service payments will be returned to the levying entity.
- Highway Infrastructure Improvements—The May Revision allows agreements between the former RDA and its sponsoring entity that relate to state highway infrastructure improvements to be an enforceable obligation of the successor agency.
- Litigation Expenses—Clarifies that a sponsoring entity can loan money to a successor agency for litigation expenses associated with challenging dissolution decisions and those loaned amounts may be repaid as an enforceable obligation if the litigation is successful.
- Reentered Agreements—Clarifies, as a result of a final court decision, that only reentered agreements entered into after the passage of Chapter 26, Statutes of 2012

(AB 1484) are unauthorized and unenforceable, unless they were for the purpose of providing administrative support activities.

Other Local Government Changes

During the Administration's stakeholder meetings on the RDA dissolution trailer bill, other local government issues were raised with Finance. The May Revision proposes addressing several of these long-standing issues as part of a comprehensive local government package that includes the RDA dissolution changes discussed above. The substantive local government amendments to be included are:

- "Negative Bailout" Counties—After Proposition 13 was passed in 1978, the state enacted legislation to provide relief to local governments for their lost property tax revenue by shifting property tax revenue from schools to cities, counties, and special districts, and then backfilling the lost school revenues from the state General Fund. The state also assumed a portion of the counties' health and welfare costs, thus freeing up county funds for other purposes. If the health and welfare costs that the state assumed for a county exceed the additional property tax the county receives from the schools, statute reduces the county's property tax revenue by the difference—this situation is termed a "negative bailout." The May Revision ends negative bailout, which will provide approximately $6.9 million in annual relief to four counties.

- Newly Incorporated Cities—Four cities in Riverside County incorporated after 2004, making them ineligible to participate in the Vehicle License Fee (VLF) Swap mechanism. The VLF Swap provides local agencies with property tax revenue to replace VLF revenue they lost when the previous Administration reduced the VLF rate from 2 percent to 0.65 percent. While the four cities did receive an enhanced share of the 0.65 percent VLF rate, that share was subsequently redirected in 2011 to fund public safety realignment. The loss of this revenue has made it arduous for these contract cities to pay Riverside County for public safety services—approximately $24 million is owed to Riverside County. The May Revision proposes to absolve these cities of this one-time debt by reducing the reimbursements Riverside County must provide to the Department of Forestry and Fire Protection (CalFIRE) for fire services. Riverside County will then forgive the debt to the four cities and the General Fund will backfill CalFIRE for its reduced reimbursements.

- San Benito County—Beginning in 1998, the County of San Benito made a series of errors in calculating the amounts owed by local agencies to the County's Educational Revenue Augmentation Fund (ERAF). While the state backfilled the $4 million the schools lost due to these errors, the local agencies that pay into ERAF must now reimburse the $4 million to the state. The May Revision allows local agencies in San Benito County to participate in an ERAF repayment program for which they are currently ineligible. This results in the state forgiving approximately $3.4 million of the $4 million owed.
- Tax Equity Allocations—Tax Equity Allocations (TEA) provide property tax to cities that levied little or no property tax prior to Proposition 13. Under TEAs, a share of the property tax otherwise payable to the county is instead provided to the city. Currently, four cities in Santa Clara County reimburse the County ERAF for the revenue the ERAF loses because of the TEA allocations. This annual ERAF loss, which is about $2 million, results from Santa Clara County's ERAF payment calculation, which excludes the amount it provides to the cities under the TEA. The May Revision ends the requirement for the cities to reimburse the County ERAF for the TEA allocations over a five-year period.
- Prior Years Insufficient ERAF—Since 2011-12, the state has provided backfills to cities and counties when there is insufficient revenue in the County ERAF to reimburse the cities and counties for their VLF Swap and "Triple-Flip" costs. Backfills are generally provided two years in arrears. The May Revision provides $5.8 million in backfills, which includes $700,000 for shortfalls incurred in 2009-10 and 2011-12.

State Mandate Reimbursements

The Commission on State Mandates is a quasi-judicial body that determines whether local agencies and school districts are entitled to reimbursement by the state for costs related to new or higher levels of service mandated by the state. The Constitution was amended in 2004 to require the Legislature to either fund or suspend specified mandates in the annual Budget Act. Currently, the state owes counties, cities, and special districts $765 million in mandate reimbursements for costs incurred prior to 2004 that must be repaid by 2020-21 under current law. This is down from the $800 million estimated in the Governor's Budget due to updated interest calculations.

Significant Adjustment:

- Trigger Mechanism Update—The 2014 Budget Act includes a trigger mechanism that makes additional payments for the remaining pre-2004 mandate debt if the estimated General Fund revenues for 2013-14 and 2014-15 fiscal years at the 2015 May Revision exceed the 2014 Budget Act's estimate for those same revenues. Current estimates indicate the trigger mechanism calculation will result in a total of $765 million, which will fully satisfy the remaining pre-2004 mandate debt. This amount is $232 million more than what was estimated in the Governor's Budget. Of the $765 million, approximately 77 percent will go to counties, 22 percent to cities, and 1 percent to special districts. These funds will provide counties, cities, and special districts with general purpose revenue. It remains the Administration's expectation that local governments use these funds for core services such as public safety, particularly to improve the implementation of 2011 Realignment and address mental health issues of local offenders.

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Statewide Issues and Various Departments

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

Sustaining State Health Care Benefits

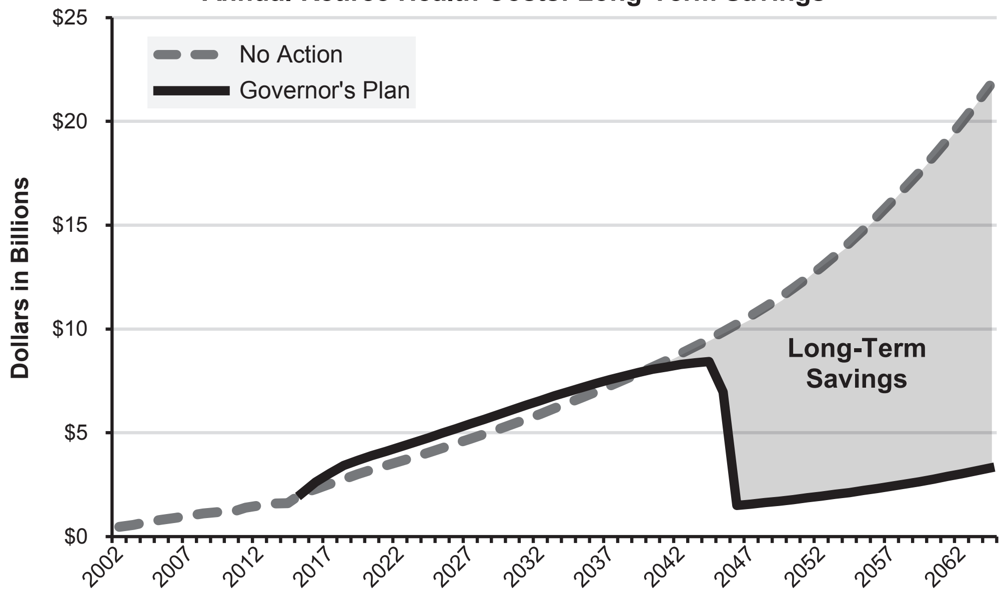
The Administration continues to pursue important changes to the state's health care program for state employees and retirees through both the collective bargaining process and legislation to address the continued escalation of premium costs and liabilities, including a $72 billion unfunded liability for retiree health care that grows every year and will reach more than $90 billion over the next five years.

Recognizing the inherent unsustainability of these rising costs, which include the pending Affordable Care Act penalty, known as the "Cadillac Tax," the Governor's Budget presented a comprehensive plan to make health care costs more affordable to the state and, ultimately, its employees. A three-pronged approach was introduced to accomplish the goal of sustaining both the affordability of state health care benefits and the benefits themselves.

First, the Governor's Budget proposed partnering with state employees to share in the prefunding of retiree benefits going forward. By holding these contributions in a trust fund that earns investment income, the state can eliminate the large unfunded liability in about 30 years and avoid significant costs in the future. Figure SWE-01 shows that once the state switches from a pay-as-you-go funding model to one that uses prefunding

Figure SWE-01

Annual Retiree Health Costs: Long-Term Savings



contributions and investment income—similar to how pensions have been funded for decades—the state's annual payment for retiree health care benefits is reduced by more than $8 billion.

Second, the Governor's Budget proposed controlling costs by reducing the employer subsidy for retiree health care for future state employees and requiring them to work longer to qualify for retiree health care benefits. Figure SWE-01 illustrates that these benefit changes, when combined with the prefunding strategy, will generate almost $240 billion in cumulative savings over the next 50 years.

Third, the Administration has requested additional reporting requirements and information-sharing about state employee and retiree health plans to increase oversight of the state's health care administrator—the California Public Employees' Retirement System (CalPERS)—and more health plan choices for employees through adding lower-cost plans to the benefit menu. The Administration's trailer bill proposal requires state departments and CalPERS to regularly review the eligibility of dependents enrolling in the state's health care program and ensure that retirees enroll in federally subsidized Medicare plans when they turn 65. Additionally, the trailer bill establishes a statutory standard to share prefunding costs with state employees and creates a mechanism to hold investment income gained from prefunding contributions in a trust fund until the retiree health care plan is fully funded.

Health care benefits remain an important part of the recruitment and retention strategy for the state workforce. The Administration recognizes that employees place a high value on these benefits as part of their total compensation package, and is discussing these issues through the collective bargaining process. A second trailer bill concerning retiree health benefit changes has been introduced as a placeholder pending collective bargaining negotiations.

Employee Compensation

The May Revision reflects a $57 million ($43 million General Fund) increase in employee compensation and retiree health care costs relative to the Governor's Budget. These additional costs are driven primarily by increases in health care premiums and enrollment.

The Administration has begun collective bargaining negotiations with four of the state's bargaining units representing correctional peace officers, engineers, scientists, and craft and maintenance workers. Each of these unit's contracts with the state will expire in early July 2015.

Retirement Contributions

The May Revision reflects the following adjustments for retirement costs:

- The expected rise in state contributions to CalPERS for pension costs has decreased by $110 million ($56 million General Fund) relative to the Governor's Budget. Of this incremental decrease, $19 million (General Fund) is estimated for California State University. The reduction reflects the impact of employees entering the system under the reduced benefit formula, pursuant to the Public Employees' Pension Reform Act of 2013, strong investment performance, and greater than expected contributions to the system. Overall, state contributions will increase by $338 million ($204 General Fund) over 2014-15 levels.
- State contributions to the California State Teachers' Retirement System (CalSTRS) increased by $6.8 million General Fund due to revised compensation figures for K-12 and community college teachers.

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

Figure SWE-02

State Retirement and Healthcare Contributions[1]

(dollars in millions)

	CalPERS[2]	CSU CalPERS	CalSTRS	JRS	JRS II	LRS	Active Health & Dental[3]	Retiree Health & Dental	CSU Retiree Health
2006-07	2,765		959	129	27	0	1,792	1,006	
2007-08	2,999		1,623 [4]	162	37	0	1,948	1,114	
2008-09	3,063		1,133	189	40	0	2,127	1,183	
2009-10	2,861		1,191	184	32	0	2,101	1,182	
2010-11	3,230		1,200	166	54	0	2,277	1,387	
2011-12	3,174		1,259	195	58	0	2,439	1,505	
2012-13	2,948 [5]	449 [5]	1,303	160	51	0	2,567	1,365 [5]	222 [5]
2013-14	3,269	474	1,360	188	52	1	2,697	1,383	225
2014-15[6]	4,042	543	1,486	179	63	1	2,786	1,521	263
2015-16[6]	4,338	585	1,935	190	67	1	2,954	1,622	267

1/ The chart does not include contributions for University of California pension or retiree healthcare costs.

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

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

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

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

6/ Estimated as of the 2015-16 May Revision. 2015-16 General Fund costs are estimated to be $2,281 million for CalPERS, $584 million for CSU CalPERS, $1,617 million for Retiree Health & Dental, and $1,385 million for Active Health and Dental. The remaining totals are all General Fund.

Civil Service System

The Administration continues to make progress in its efforts to improve the state's civil service system. Currently, over 28 different teams (including state employees, public employee representatives, and other stakeholders) are reviewing components of the civil service system to recommend statutory changes and practical administrative solutions to streamline, improve flexibility, and modernize programs, processes and policies. Several such proposals are described below.

- Vacant Positions — Current law includes a provision that requires the elimination of positions, that at the end of a fiscal year, have been vacant for six consecutive months or more. Intended as a mechanism to maintain accurate numbers of authorized personnel, reviews by both the Legislative Analyst's Office and the Department of Finance in recent years have recommended its repeal due to its ineffectiveness and overly bureaucratic approach. The May Revision proposes abolishing this law and replacing it with a better mechanism to provide monitoring of and greater transparency into departments' budgets. Neither existing law nor the proposed new mechanism affect how much funding a department receives. The overall goal is to more accurately reflect how departments spend their funds on personnel versus operation expenses. To this end, Finance will develop a bi-annual process for reconciling department budgets, specifically for positions and operating expenses and equipment. This reconciliation process will first take place in the 2015-16 budget year and the results will be utilized to build departments' baseline budgets in the 2016-17 Governor's Budget. The appropriate mix of funding between positions and operating budgets will be based on a department's past three years of expenditures in specified categories.

- Limited-Term Positions — Under current practice, when a department's new work is temporary in nature, it may receive limited-term positions along with temporary funding. In many cases, these positions are difficult to fill because applicants know they will need to look for a new job shortly. Once filled, workers often transfer to a different permanent job as soon as possible. Consequently, from an operational standpoint, limited-term positions make completing the necessary work even more difficult. The May Revision proposes to eliminate the use of limited-term positions going forward. Instead, Finance and the Legislature can approve limited-term spending authority that will act as a control on the number of positions a department can fill in any given year. When combined with the bi-annual reconciliation process described above, departments will be able to manage their personnel levels within budgeted funds to meet operational needs more efficiently and effectively.

- Hiring Process — The May Revision proposes eliminating several archaic statutes that impose unnecessary restrictions on departments, preventing them from hiring eligible candidates. Eliminating these restrictions will assist departments in hiring the best candidates for positions in a more timely manner.

Together, these proposals allow departments greater flexibility in hiring, managing, and ultimately running their programs, while also maintaining proper control agency and legislative oversight—all important characteristics of a nimble and improved civil service system.

Many other efforts are currently underway to review and improve the state's recruitment, hiring, training and development/retention, performance management, and strategic planning, among other areas. Some of these efforts are:

- Streamline Job Classifications—The California Department of Human Resources (CalHR) is working with a team to abolish over 400 classifications identified as "unused." Another team is working on recommendations to consolidate similar classifications, clarify classification descriptions, and assess the use of deep classes, ultimately to assist people looking for state jobs to find the opportunities that best suit their education and experience.
- Broaden Recruitment Efforts—Teams are reviewing the statewide recruitment plan and reaching out to various groups, including veterans, mid-career professionals, and the newest generation of employees (those designated "millennials"), to better understand how to attract and retain a diverse, multi-generational workforce that reflects California's population. Teams are reviewing the use of social media and other online career tools to more effectively recruit and communicate with potential employees.
- Strengthen Training Opportunities and Aligning Curriculum—To ensure a well-trained workforce, teams are looking for ways to better leverage and expand on internships, fellowships, and apprenticeships. Teams are also working with a variety of education stakeholders to consider ways to align college curriculum with the state's current and anticipated talent needs in order to prepare students for careers in state civil service.
- Revamp Job Examinations—Teams are reviewing exam-related processes for practical ways to help departments conduct job analyses and share resources to conduct consortium exams for multiple departments' use.
- Expand Department Delegation Authority—In the past several years, CalHR has delegated authority to departments for multiple tasks, including resolving unlawful appointments and approving exceptional allocations (which allow individuals to perform duties different from their assigned classification). This gives departments greater flexibility to address their management and personnel needs. A team is

identifying further opportunities for departments to exercise greater flexibility through delegated authority.

- Enhance Performance Evaluations—A team is reviewing the state's current evaluation tools and practices in attempts to align them with current trends in effective performance management. The team is exploring various coaching and mentoring programs to create work environments that encourage more employee engagement.

California Arts Council

The California Arts Council develops partnerships with the public and private sectors to provide support to the state's non-profit arts and cultural community and enhance the cultural, educational, social, and economic development of California.

Significant Adjustment:

- Permanent Funding Increase—$5 million ongoing General Fund to provide additional grants to local arts organizations. These funds will be used to further the arts in the program areas of Economic and Community Development, Arts Education, Cultural and Community Engagement, and the Creative Economy.

Judicial Branch

The Judicial Branch consists of the Supreme Court, courts of appeal, trial courts and the Judicial Council. The trial courts are funded with a combination of resources from the General Fund, county maintenance-of-effort requirements, fees, and other charges. All other portions of the Judicial Branch primarily receive funding from the General Fund. The May Revision includes total funding of $3.8 billion ($1.7 billion General Fund) for the Judicial Branch.

Significant Adjustments:

- Trial Court Trust Fund Revenues—The May Revision includes an additional $15.5 million General Fund to reflect a further reduction of fines and penalty revenues estimated to be collected in 2015-16, for a total of $66.2 million that is available for transfer to the Trial Court Trust Fund.

Debt Service

The May Revision reflects the following adjustments for debt service costs:

- Current Year Debt Service — General Fund debt service expenditures have increased by $35.3 million compared to the Governor's Budget, for a total of $5.2 billion. This reflects increased General Obligation debt service costs ($4.7 billion total) and no change for lease revenue bond debt service costs ($505.3 million total). The minor increase in General Obligation debt service cost is a result of bond issuances over the previous years increasing debt service costs at a faster pace than bonds being retired.

- Budget Year Debt Service — General Fund debt service expenditures will decrease by $161.7 million compared to the Governor's Budget, to a total of $5.4 billion. This adjustment reflects reduced General Obligation debt service costs ($4.8 billion total) and lease revenue bond debt service costs ($535.8 million total). The decrease in General Obligation debt service is primarily attributable to: (1) a smaller spring 2015 bond sale than projected, (2) increased estimated premium on future bond sales, and (3) savings related to bond refinancings this spring. The decrease in lease revenue bond debt service costs is attributable to savings related to bond refinancings this spring. The Department of Finance continues to work with departments to manage bond cash and ensure bonds are issued only when necessary.

State Appropriations Limit Calculation

2015-16 State Appropriations Limit (SAL) Calculation — Pursuant to Article XIIIB of the California Constitution, the 2015-16 SAL is estimated to be $94.042 billion. This amount is used for various calculations related to state budgeting. The revised limit is the result of applying the growth factor of 4.55 percent. The revised 2015-16 limit is $899 million above the $93.1 billion estimated in January. This increase is due to changes in the following factors:

- Per Capita Personal Income
  - January Percentage Growth: 2.91%
  - May Revision Percentage Growth: 3.82%
- State Civilian Population

    - January Percentage Growth: 0.88%
    - May Revision Percentage Growth: 0.94%
- K-14 Average Daily Attendance
    - January Percentage Growth: 0.31%
    - May Revision Percentage Growth: 0.39%

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Economic Outlook

Economic growth was strong in 2014, resulting in an improved overall outlook for California. Jobs are being added faster than anticipated and the unemployment rate is falling both nationally and in the state. Meanwhile, the falling price of crude oil has kept inflation low and supported higher consumer spending. Although California is experiencing an exceptional drought in 2015, the economy is the most diverse in the United States, and growth in other sectors is expected to keep the overall impacts small.

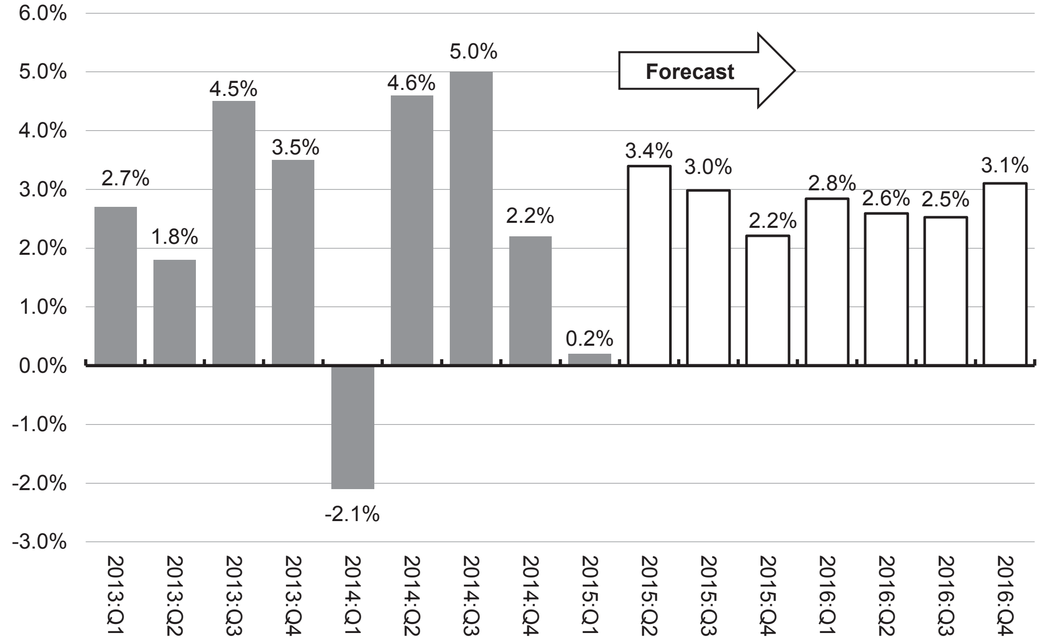
The outlook assumes that global growth remains slow but steady. Risks to the economy continue to include a correction in the stock market or a weaker global economy.

The Nation – Solid Growth

The nation's economy continues to grow at a steady pace, with lower unemployment and more jobs being added. Real Gross Domestic Product (GDP) growth in 2014 was 2.4 percent, and is expected to maintain momentum in 2015 and 2016 in spite of the slow growth in the first quarter of 2015 (see Figure ECO-01). The slow growth in the first quarter was largely due to poor weather in the East and other temporary factors.

Real GDP growth is supported by stronger consumption growth as people find jobs and spend less on gasoline. As of April 2015, the national unemployment rate fell to 5.4 percent. The decrease in unemployment is due partially to slower growth in the labor force as more workers born during the baby boom reach retirement age. However, payroll job growth has been solid at 3.1 million in 2014 and is expected to continue.

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



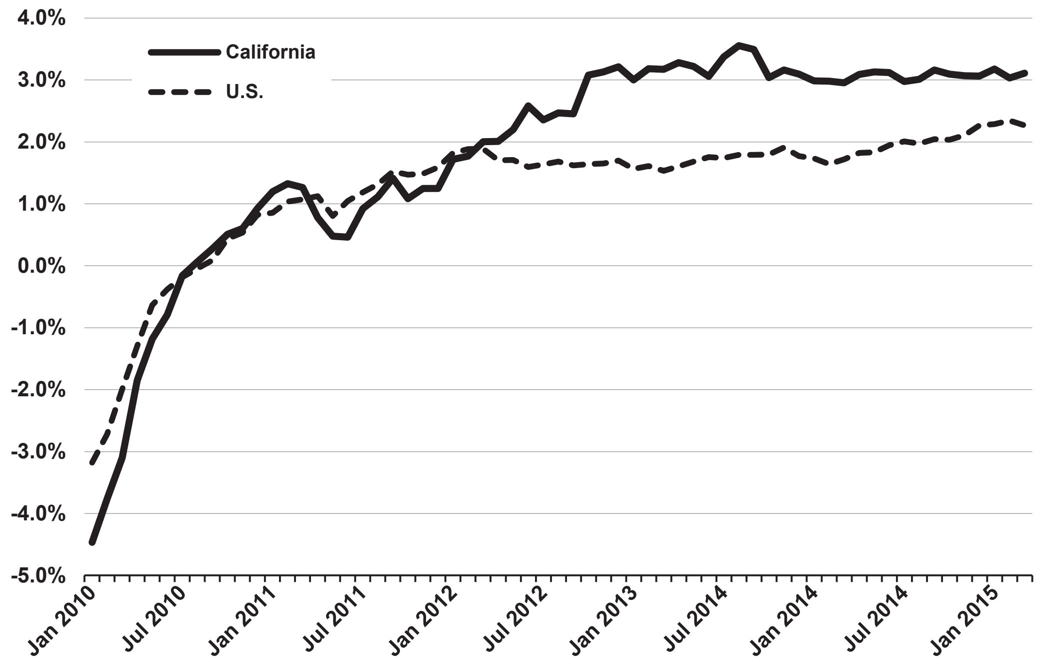
Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

After the Governor's Budget forecast was finalized, oil prices fell by more than 30 percent before rebounding slightly in April 2015. Prices are now expected to rise gradually over the forecast, but are still lower than the previous forecast. Lower gasoline prices allow consumers to buy other goods, supporting growth. Besides the growth in personal consumption, investment is also beginning to pick up, both in the housing sector and by businesses. However, exports are expected to grow more slowly in coming years due to weaker global growth. The Federal Reserve has not specified when it will raise the interest rate, and the forecast assumes this will begin in the second half of 2015 and gradually thereafter as the economy improves.

California – Balanced Growth

California's employment in 2014 grew at a stronger pace than previously estimated. The unemployment rate dropped to 6.5 percent in March 2015. California is expected to continue to add jobs at a steady pace, and March marked the state's 56th consecutive month of nonfarm job growth since August 2010 (see Figure ECO-02). However, the unemployment rate is not expected to fall below 6 percent until near the end of

Figure ECO-02
California and U.S. Nonfarm Employment
Year-over-Year Percent Change



Source: California Employment Development Department, Labor Market Information Division

2016 as younger workers join the labor force in large numbers. In addition, although the drought will affect the farm sector in 2015, the forecast assumes the drought does not continue into 2016. The impact on other sectors is expected to be limited, with small overall impacts given California's diversified economy.

Personal income also increased in 2014 more than previously estimated, and is consistent with more people finding work and business profits rising. All eleven major industry sectors added jobs in 2014—the first time this has happened since the recovery began in 2009. The increase in wages is offset in part by slower growth in interest and other investment income, given a more gradual increase in interest rates.

The number of housing permits issued remained unchanged in 2014 compared with 2013. Issuance began to increase in early 2015, and the forecast expects this trend to continue. Housing prices, as measured by the median sales price of existing single-family homes, continue to increase. Non-residential permits grew strongly, by 13.4 percent on average in 2014, and are expected to maintain solid growth.

Consumer inflation, as measured by the Consumer Price Index (CPI), has been relatively low throughout the recovery. It is expected to be around 1 percent in 2015 due to the drop in oil prices before rebounding to around 2 percent over the remaining forecast period. However, housing prices have been rising faster than the overall index, particularly in the San Francisco area, and are expected to keep inflation somewhat higher.

See Figure ECO-03 for highlights of the national and California forecasts.

Risks to Consider

There are a few key risks in the economy in the short term. For instance, one potential risk is that there could be a correction in the stock market. 2014 marked the sixth year of positive growth in the stock market. Annual growth averaged more than 12 percent in both the Dow Jones Industrial Average and S&P 500 Indices over these six years, a much faster rate of increase than in the overall economy. Pessimism about economic growth prospects could lead to a correction in the stock market.

In addition, many of the United States' major trade partners, including China and European Union countries, have recently experienced economic slowdowns. One direct impact of global economic slowdowns is that these trade partners purchase fewer products from the United States, which could lead to slower economic growth for the United States. This global slowdown could directly impact California's corporate profits, employment, and personal income.

Figure ECO-03

Selected Economic Indicators

United States	2010	2011	2012	2013	2014	2015 Projected	2016 Projected
Nominal gross domestic product, $ billions	$ 14,964	$ 15,518	$ 16,163	$ 16,768	$ 17,419	$ 18,117	$ 18,964
Real gross domestic product, percent change	2.5%	1.6%	2.3%	2.2%	2.4%	2.8%	2.7%
Contributions to real GDP growth							
Personal consumption expenditures	1.3%	1.6%	1.3%	1.6%	1.7%	2.2%	2.1%
Gross private domestic investment	1.7%	0.7%	1.3%	0.8%	0.9%	0.7%	1.2%
Net exports	-0.5%	0.0%	0.0%	0.2%	-0.2%	-0.3%	-0.7%
Government purchases of goods and services	0.0%	-0.7%	-0.3%	-0.4%	0.0%	0.2%	0.1%
Personal income, $ billions	$ 12,429	$ 13,202	$ 13,888	$ 14,167	$ 14,729	$ 15,302	$ 15,983
Corporate profits, percent change	25.0%	4.0%	11.4%	4.2%	-0.8%	8.0%	6.5%
Housing permits, thousands	605	624	830	991	1,040	--	--
Housing starts, thousands	586	612	784	930	1,001	1,121	1,308
Median sales price of existing homes	$ 173,100	$ 166,200	$ 177,200	$ 197,400	$ 208,900	--	--
Federal funds rate, percent	0.2%	0.1%	0.1%	0.1%	0.1%	0.3%	1.2%
Consumer price index, percent change	1.6%	3.2%	2.1%	1.5%	1.6%	0.0%	2.2%
Unemployment rate, percent	9.6%	8.9%	8.1%	7.4%	6.2%	5.5%	5.2%
Civilian labor force, millions	153.9	153.6	155.0	155.4	155.9	157.9	160.1
Nonfarm employment, millions	130.3	131.8	134.1	136.4	139.0	141.9	144.0
California							
Personal income, $ billions	$ 1,579	$ 1,686	$ 1,805	$ 1,857	$ 1,944	$ 2,038	$ 2,144
Made-in-California exports, percent change	19.3%	11.3%	1.5%	3.9%	3.6%	--	--
Housing permits, thousands	44	47	59	86	86	99	111
Housing unit change, thousands	36	36	45	59	69	--	--
Median sales price of existing homes	$ 305,010	$ 286,040	$ 319,310	$ 407,150	$ 447,010	--	--
Consumer price index, percent change	1.3%	2.6%	2.2%	1.5%	1.8%	1.0%	2.3%
Unemployment rate, percent	12.1%	11.6%	10.2%	8.8%	7.5%	6.5%	6.0%
Civilian labor force, millions	18.3	18.4	18.5	18.6	18.8	19.0	19.1
Nonfarm employment, millions	14.2	14.4	14.7	15.2	15.7	16.1	16.5
Percent of total nonfarm employment							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	3.9%	3.9%	4.0%	4.2%	4.3%	4.5%	4.7%
Manufacturing	8.8%	8.7%	8.5%	8.3%	8.1%	7.9%	7.7%
High technology	2.4%	2.4%	2.3%	2.2%	2.1%	2.1%	2.0%
Trade, transportation, and utilities	18.5%	18.6%	18.6%	18.4%	18.4%	18.4%	18.3%
Information	3.0%	3.0%	3.0%	3.0%	2.9%	2.9%	2.9%
Financial activities	5.3%	5.3%	5.3%	5.2%	5.0%	5.0%	5.0%
Professional and business services	14.6%	14.9%	15.2%	15.4%	15.6%	15.7%	15.8%
High technology	2.2%	2.3%	2.4%	2.4%	2.6%	2.7%	2.9%
Educational and health services	14.5%	14.5%	14.8%	15.3%	15.3%	15.3%	15.3%
Leisure and hospitality	10.6%	10.7%	10.9%	11.0%	11.2%	11.3%	11.4%
Other services	3.4%	3.4%	3.4%	3.4%	3.5%	3.6%	3.6%
Government	17.2%	16.7%	16.2%	15.6%	15.4%	15.3%	15.1%

Forecast based on data available as of April 2015
Percent changes calculated from unrounded data.

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Revenue Estimates

After accounting for transfers such as to the Rainy Day Fund, General Fund revenues under the May Revision forecast are higher than at the Governor's Budget by $700 million in 2013-14, $3.3 billion in 2014-15, and $1.7 billion in 2015-16. Excluding transfers and the revenue loss associated with the proposed Earned Income Tax Credit, revenues are $6.7 billion higher over these years. Figure REV-01 compares the revenue forecasts, by source, in the Governor's Budget and the May Revision. Total May Revision revenue, including transfers, is projected to be $111.3 billion in 2014-15 and $115 billion in 2015-16.

The economic forecast has improved somewhat since the Governor's Budget. The improved economic forecast, along with the strong cash trends through April support the significant increase in revenues. On net, cash tax receipts are up about $3.2 billion over the forecast through the end of April. Cash data through April suggest that personal income tax receipts are up about $2.7 billion, corporation tax receipts are up almost $250 million, and sales and use tax (sales tax) receipts are up $230 million.

A cash surplus or shortfall can have different effects on the revenue forecast for all three open revenue years, depending on the source of the cash and other factors such as accruals.

Figure REV-01
2015-16 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 13-14: *Final*				
Personal Income Tax	$66,560	$67,025	$466	0.7%
Sales and Use Tax	22,263	22,263	0	0.0%
Corporation Tax	8,858	9,093	234	2.6%
Insurance Tax	2,363	2,363	0	0.0%
Alcoholic Beverage	354	354	0	0.0%
Cigarette	86	86	0	0.0%
Other Revenues	1,813	1,814	0	0.0%
Subtotal	**$102,298**	**$102,998**	**$700**	0.7%
Transfers	376	376	0	0.0%
Total	**$102,675**	**$103,375**	**$700**	0.7%
Fiscal 14-15				
Personal Income Tax	$71,699	$75,384	$3,686	5.1%
Sales and Use Tax	23,438	23,684	246	1.0%
Corporation Tax	9,618	9,809	191	2.0%
Insurance Tax	2,490	2,486	-4	-0.2%
Alcoholic Beverage	367	353	-14	-3.7%
Cigarette	84	84	0	0.0%
Other Revenues	1,954	1,556	-398	-20.4%
College Access Transfer	600	4	-596	
Subtotal	**$110,250**	**$113,361**	**$3,110**	
Other Transfers [/1]	-2,208	-2,054	154	-7.0%
Total	**$108,042**	**$111,307**	**$3,265**	3.0%
Fiscal 15-16				
Personal Income Tax	$75,213	$77,700	$2,487	3.3%
Sales and Use Tax	25,166	25,240	74	0.3%
Corporation Tax	10,173	10,342	168	1.7%
Insurance Tax	2,531	2,556	26	1.0%
Alcoholic Beverage	374	360	-14	-3.7%
Cigarette	82	82	0	0.0%
Other Revenues	1,594	1,652	59	3.7%
College Access Transfer	350	100	-250	
Subtotal	**$115,482**	**$118,031**	**$2,549**	2.2%
Other Transfers [/1]	-2,102	-2,999	-897	42.7%
Total	**$113,380**	**$115,033**	**$1,653**	1.5%
Three-Year Total (including BSA transfer)			**$5,617**	

Note: Numbers may not add due to rounding.

[/1] Includes transfers to Budget Stabilization Account for 2014-15 and 2015-16.

- Personal income taxes are higher by $466 million in 2013-14, $3.3 billion in 2014-15, and $2.3 billion in 2015-16 due to strong withholding growth, as well as growth in capital gains and partnership income.
- Corporation taxes are higher by $234 million in 2013-14, $60 million in 2014-15, and $100 million in 2015-16 due to strong cash trends.
- In addition to the changes described above, lower utilization of the College Access Tax Credit increases personal income tax and corporation tax receipts by several hundred million dollars (offset by a similar decrease to General Fund transfers).
- Sales tax receipts are higher by $246 million in 2014-15 and $74 million in 2015-16. Much of the current-year revenue gain is attributable to lower utilization of the recent manufacturing sales tax exemption in the first two quarters of 2014-15.

Long-Term Forecast

The May Revision economic forecast reflects steady growth over the next four years. The projected average growth rate in U.S. real gross domestic product over the next four years is 2.6 percent. While the forecast does not project a recession, the current expansion has already exceeded the average post-war expansion by over a year.

Figure REV-02 shows the forecast for the largest three General Fund revenues from 2013-14 through 2018-19. Total General Fund revenue from these sources is expected to grow from $98.4 billion in 2013-14 to $123.5 billion in 2018-19. The average year-over-year growth rate over this period is 4.8 percent.

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

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	Average Year-Over-Year Growth
Personal Income Tax	$67.0	$75.4	$77.7	$81.7	$84.7	$84.2	4.7%
Sales and Use Tax	$22.3	$23.7	$25.2	$25.8	$25.9	$27.1	4.0%
Corporation Tax	$9.1	$9.8	$10.3	$11.1	$11.7	$12.2	6.1% #NUM!
Total	**$98.4**	**$108.9**	**$113.3**	**$118.5**	**$122.2**	**$123.5**	4.8%
Growth	6.1%	10.7%	4.0%	4.6%	3.2%	1.0%	

Note: Numbers may not add due to rounding.

Earned Income Tax Credit

The May Revision proposes an Earned Income Tax Credit to help the poorest working families in California. This targeted Earned Income Tax Credit would provide a refundable tax credit for wage income, and would focus on the lowest income Californians—households with income less than $6,580 if there are no dependents or less than $13,870 if there are three or more dependents. The proposed state program complements the existing federal Earned Income Tax Credit. The proposed state credit would match 85 percent of the federal credits up to half of the federal phase-in range and then begin to taper off relative to these maximum wage amounts. This targeted approach will allow a greater benefit per household. The credit will be available beginning with tax returns filed for wages earned in 2015. The tax credit is expected to reduce revenues by $380 million annually beginning in 2015-16. It will benefit an estimated 825,000 families and 2 million individuals. The estimated average household benefit is $460 per year, with a maximum credit of $2,653.

Personal Income Tax

Compared to the Governor's Budget, the personal income tax forecast is higher by $466 million in 2013-14, $3.3 billion in 2014-15, and $2.3 billion in 2015-16. Over the three-year period, the personal income tax forecast reflects a total increase of $6.1 billion. In addition, the lower utilization of the College Access Tax Credit increases personal income tax receipts and reduces the General Fund transfer.

The forecast reflects an increase in wages based on withholding levels that continue to be very strong. Through April, withholding is up nearly 6 percent from 2014—a year when withholding growth was near 10 percent. Withholding growth significantly outpaced wage growth in 2014, suggesting that a higher share of the wage gains have gone to high-income earners who pay higher tax rates.

Based on 2013 tax return data, partnership income was stronger than had been anticipated and is expected to grow over the next few years. In addition, lower interest rates have decreased mortgage interest deductions. Since deductions reduce taxable income, a lower forecast for deductions increases the revenue forecast.

Capital gains increased in 2014 due to strong cash receipts related to 2014 tax liability. The sustained strong performance of the stock market over the past several years is expected to lead to continued above-normal capital gains through 2016 because some of the gains that individual taxpayers accrued during these years will be realized in 2015 and 2016. Specifically, capital gains income was revised up from $115 billion to $120 billion in 2014, $103 billion to $116 billion in 2015, and $98 billion to $109 billion in 2016. The forecast assumes capital gains return to normal levels in relation to personal income by 2017—one year later than was previously estimated. Preliminary actual capital gains income in 2013 was $79 billion compared to the $80 billion forecast.

The personal income tax forecast includes Proposition 30 revenues, which are estimated at $6.6 billion in 2014-15 and $6.7 billion in 2015-16.

Sales and Use Tax

The sales tax forecast reflects an increase of $246 million in 2014-15 and $74 million in 2015-16. This includes Proposition 30 revenues totaling $1.5 billion in 2014-15 and $1.6 billion in 2015-16.

The increase in the sales tax forecast is largely due to lower than estimated utilization of the manufacturing exemption credit and higher wages.

Corporation Tax

The corporation tax forecast reflects an increase of $234 million in 2013-14, $60 million in 2014-15, and $100 million in 2015-16. Lower utilization of the College Access Tax Credit increases corporation tax receipts and reduces the General Fund transfer.

Compared to the Governor's Budget, the revenue increase in 2013-14 and 2014-15 can be attributed mainly to higher cash receipts through April 2015.

Insurance Tax

The insurance tax forecast reflects a decrease of $4 million in 2014-15 and an increase of $26 million in 2015-16. The revenue changes are primarily due to a lower refund estimate related to a Board of Equalization decision in the *California Automobile Insurance Company* case.

Loan Repayments to Special Funds

The Governor's Budget reflected repayment of loans based on the operational needs of various special fund programs and Proposition 2's dedicated funding stream for reducing debts and liabilities. The May Revision includes an increase of $537 million in loan repayments to special funds in 2015-16. This is a result of the increased debt payment requirement imposed by Proposition 2 reflecting an increase in forecasted revenues and capital gains since the Governor's Budget.

Property Tax

The May Revision estimates statewide property tax revenues will increase 6.14 percent in 2014-15 and 5.52 percent in 2015-16, which is slightly higher than the respective 6.1-percent and 5.25-percent growth rates estimated at Governor's Budget. Roughly 41 percent ($16.7 billion) will go to K-14 schools in 2015-16. While this includes $1 billion that schools are expected to receive pursuant to the dissolution of the redevelopment agencies, it excludes $409 million shifted from schools to cities and counties to replace sales and use tax revenues redirected from those entities to repay the Economic Recovery Bonds. It also excludes the $7.2 billion shifted 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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