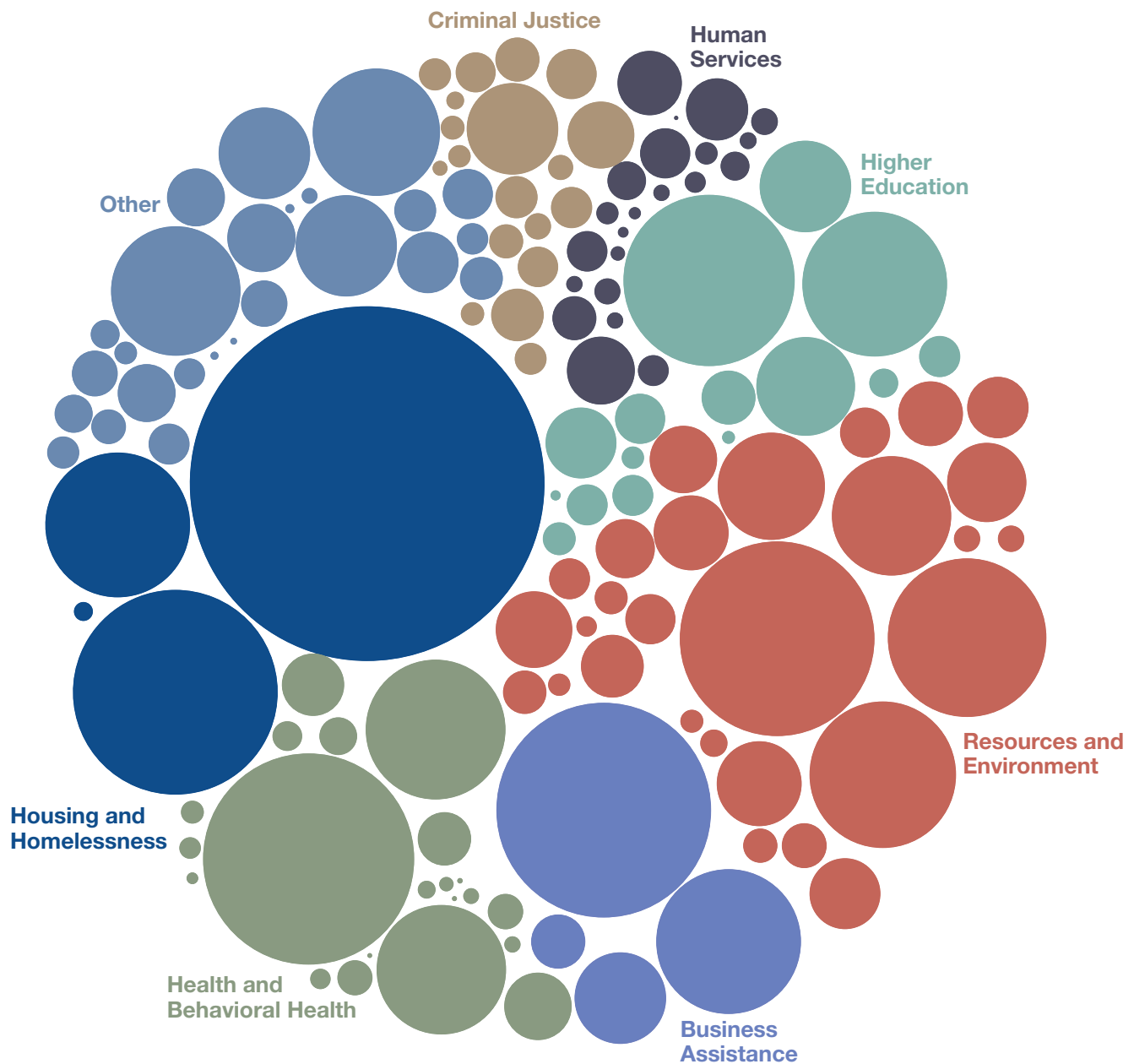


The 2021-22 Budget: **Overview of the Governor's Budget**

How the Governor Allocates \$15.5 Billion
Windfall Among His Spending Proposals



Executive Summary

State Fiscal Picture Has Improved Amidst Continued Crisis. The pandemic disrupted the livelihoods of millions of Californians and takes the lives of thousands of Californians each month. Last year, the Legislature faced an unprecedented challenge to adopt a budget facing extraordinary uncertainty. Today, however, the state's fiscal picture is quite different. Under the Governor's budget, revenues are nearly back to pre-pandemic levels and state costs have not risen as dramatically as anticipated. While the crisis is still ongoing, this budget offers the Legislature an opportunity to consider how the state can best use its resources to help California respond and recover.

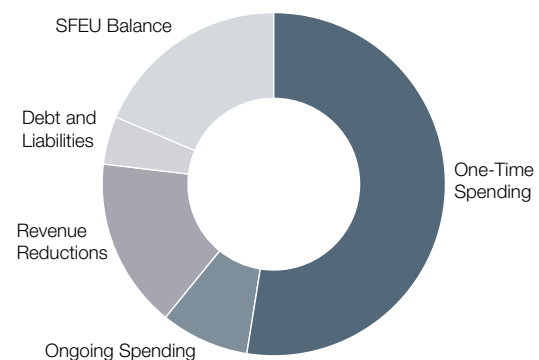
State Has Significant Windfall to Allocate in 2021-22, but Faces Multiyear Challenges. Under the Governor's budget, the state would end 2021-22 with \$18.9 billion in total reserves, an increase of \$7.5 billion over the last year's enacted level. This increase is the result of constitutionally required reserve deposits, which reflect much stronger than anticipated revenue growth. In addition, we estimate the Governor had a significant windfall—\$15.5 billion—to allocate in developing his 2021-22 budget proposal. However, the state budget faces challenges over the longer term. In particular, the administration anticipates the state would have operating deficits if the Legislature adopted the Governor's budget proposals, reaching \$11.3 billion in 2024-25.

Governor's Budget Proposals Focus on One-Time Spending. The figure below shows how the Governor proposes the Legislature allocate the \$15.5 billion windfall. In particular, the Governor proposes spending over half of the windfall on one-time or temporary purposes. This report describes the various major budget proposals in more detail, offers some initial assessments, and provides Appendix figures detailing the Governor's proposals for the windfall.

Overall LAO Comments

Recent Federal Pandemic Relief Should Inform State Actions. In late December, the federal government passed a fifth round of pandemic relief, providing additional funding to most taxpayers, people receiving unemployment insurance benefits, renters, businesses, and schools. The Governor's budget includes a number of significant proposals that address similar pandemic-related needs. While this overlap is understandable given the timing, it would be prudent to examine the Governor's proposal in light of the new federal relief. Specifically, we recommend the Legislature: (1) determine how to best target state funds to those not benefiting from the federal assistance, and (2) strive to complement, rather than duplicate, the federal activities.

How the Governor Allocates a \$15.5 Billion Windfall



SFEU = Special Fund for Economic Uncertainties.

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Assessment of Governor's Immediate Action Proposals. The Governor's budget includes \$5 billion in actions he proposes the Legislature adopt within the next few weeks. First, the Governor proposes \$2 billion for in-person instruction grants connected to a school reopening proposal. We are concerned this proposal sets unfeasible time lines. Second, the Governor proposes providing \$2.4 billion in tax refunds to low-income taxpayers, which we think could be more targeted. Third, we agree the Governor's proposal to provide \$550 million in small business grants is worth considering. Fourth, the Governor's proposal to waive fees for individuals and businesses directly affected by the state's stay-at-home orders is reasonable.

Framework for Considering Early Action Proposals. The Governor proposes over two dozen proposals costing \$7.8 billion that he is asking the Legislature to pass in the early spring. We recommend the Legislature consider each proposal separately and ask a series of questions to determine if the proposals warrant early action. These questions are: (1) Does the administration provide sufficient evidence of a problem? (2) Is the proposal time sensitive? (3) Is the entire funding amount time sensitive? (4) Is there sufficient detail in the plan to assess its potential success?

Restoring Budget Resilience. In June 2020, the state took a number of actions—including making withdrawals from reserves and shifting costs—that were larger than necessary. In light of this fact, as well as continued economic uncertainty and anticipated future deficits, we think it is important that the state restore most or all of that budget resilience. The Governor's interpretation of the constitutional requirement results in a sizeable deposit to rebuild some budget resilience, but he uses very few discretionary proposals to restore these tools. We agree the state should remain focused on the crisis at hand, but taking some of these actions now is nonetheless important both to address the state's multiyear budget problem and help California weather the next unexpected downturn.

OVERVIEW OF THE GOVERNOR'S BUDGET

The state's fiscal situation has continued to rapidly evolve since the beginning of the coronavirus disease 2019 (COVID-19) pandemic last year. Although the state economy abruptly ground to a halt in the spring with the emergence of COVID-19, it has experienced a quicker rebound than expected. While negative economic consequences of the pandemic have been severe, they do not appear to have been as catastrophic from a fiscal standpoint as the budget anticipated. But, the recovery has been uneven. Many low-income Californians remain out of work, while most high-income workers have been spared.

On January 8, 2021, Governor Newsom presented his proposed state budget to the

Legislature. In this report, we provide a brief summary of the proposed budget based on our initial review. In the coming weeks, we will analyze the plan in more detail and release several additional budget analyses.

The objective of this report is to summarize the Governor's budget structure and major proposals for the Legislature, including any themes that emerged as we conducted our preliminary review. We also provide our initial assessment of the structure of the budget and raise issues for legislative consideration on the major budget proposals.

GENERAL FUND WINDFALL UNDER THE GOVERNOR'S BUDGET

Budget Condition

Figure 1 shows the General Fund condition based on the Governor's proposals and using the administration's estimates and assumptions.

Total Reserves Reach \$18.9 Billion. The bottom of Figure 1 shows total reserves planned for the end of 2021-22 under the administration's estimates and assumptions. Under the Governor's proposed budget, the state would end 2021-22 with \$18.9 billion in total reserves. This represents an increase of \$7.5 billion over the enacted reserve level of \$11.4 billion in 2020-21. The increase is the result of three factors:

- **Deposit of \$3 Billion in BSA for 2021-22.** Proposition 2 (2014) requires the Legislature to set aside monies each year in the state's constitutional

reserve, the Budget Stabilization Account (BSA). Generally, these reserve deposits are higher when the state collects more revenues. Under the administration's revenue estimates,

Figure 1

General Fund Condition Summary (In Millions)

	2019-20 Revised	2020-21 Revised	2021-22 Proposed
Prior-year fund balance	\$11,292	\$5,359	\$12,203
Revenues and transfers	140,623	162,742	158,370
Expenditures	146,556	155,898	164,516
Ending fund balance	\$5,359	\$12,203	\$6,058
Encumbrances	\$3,175	\$3,175	\$3,175
SFEU balance	2,184	9,028	2,883
Reserves			
BSA	\$17,120	\$12,536	\$15,574
SFEU	2,184	9,028	2,883
Safety net	900	450	450
Total Reserves	\$20,204	\$22,014	\$18,907

SFEU = Special Fund for Economic Uncertainties and BSA = Budget Stabilization Account.

the state is required to make a \$3 billion deposit into the BSA in 2021-22.

- **\$4.2 Billion in Reserve Deposit Adjustments.** Proposition 2 also requires the state to revise, or “true up,” BSA deposits for the two preceding fiscal years based on updated revenue estimates. Under the administration’s assumptions, the state would need to make \$4.2 billion in true-up deposits to the BSA for 2019-20 and 2020-21 due to notably improved revenue estimates since the *2020-21 Budget Act*. Of this total, \$3.2 billion is due to the administration’s interpretation of the constitutional rules (see the nearby box).
- **Increase in the Discretionary Reserve Balance of \$267 Million.** The state’s main discretionary reserve is called the Special Fund for Economic Uncertainties (SFEU). The 2020-21 budget package enacted a discretionary reserve balance of \$2.6 billion and the Governor proposes a year-end balance of \$2.9 billion in that reserve.

Administration Estimates Large Multiyear Operating Deficits. An operating deficit occurs when baseline expenditure growth outpaces anticipated revenue growth. Both our office and the administration anticipate this is the case. In our November *Fiscal Outlook*, we found the state faces large and growing multiyear operating deficits over the outlook period. Under its own revenue forecast, the administration also anticipates the state would face operating deficits if the Legislature adopted the Governor’s budget proposals. Specifically, these deficits would grow from \$7.6 billion in 2022-23 to \$11.3 billion in 2024-25.

Windfall

We Estimate Governor Allocated a Windfall of \$15.5 Billion. We estimate the Governor had a \$15.5 billion windfall to allocate in the 2021-22 budget process. This is slightly larger than the \$15 billion surplus the Governor has cited. Both our office and the administration estimate the budget “surplus” or “windfall” by estimating the amount of discretionary spending in the budget. We define discretionary spending as new spending not required under law or to maintain current service levels. In a number of areas, our office and the administration differ on whether a spending proposal is discretionary or not. For example, recent budgets made a number of programmatic spending amounts subject to suspension under certain conditions. Those conditions are not met, so we do not count funding those program amounts as discretionary, although the administration does.

Comparison to LAO November Outlook. In our *Fiscal Outlook* released in November 2020, our office anticipated the state would have a windfall of \$26 billion, significantly higher than the windfall allocated in the Governor’s budget. There are a few major sources of this difference. Specifically, the administration’s estimates include:

- **Much Higher BSA Deposits and Constitutional Debt Requirements.** Across the budget window, the administration anticipates the state will have \$5.6 billion in higher required reserve deposits and debt payments under the requirements of Proposition 2. This is due to the

Governor’s Interpretation of Constitutional True-Up Rules

The constitution requires the state to make annual deposits into the Budget Stabilization Account (BSA) unless the withdrawal is reduced or suspended under a budget emergency. The state also must revise, or “true up,” BSA deposits for the two preceding fiscal years as revenue estimates are updated. In 2020-21, the state suspended the required BSA deposit and withdrew \$7.8 billion from the BSA. The administration’s interpretation of the constitutional rules is that the state still must make a true-up deposit for the year in which the deposit was suspended. This results in an increased reserve requirement of \$3.2 billion. This interpretation is not unreasonable, but other interpretations are plausible.

administration's interpretation of true up requirements and higher estimates of capital gains revenues.

- **Higher Direct COVID-19-Related Costs.** The administration estimates direct COVID-19 expenditures, which we do not consider discretionary, are higher by \$4.4 billion compared to the budget act assumption. (We define direct COVID-19 expenditures to include expenses for testing, contact tracing, and vaccine distribution.) In our Outlook, we assumed these costs would be higher than 2020-21 by only \$2.8 billion. In addition, the administration appears to assume a much lower federal reimbursement rate on COVID-19 expenditures, resulting in an additional \$1.2 billion in costs relative to our November estimates. On net, the administration estimates COVID-19-related costs are \$2.8 billion higher than we assumed.

- **Higher Spending on Caseload-Driven Programs.** Across the state's major health and human services programs, the administration's estimates of General Fund spending is higher by nearly \$2 billion compared to our estimates. Most of these differences are in Medi-Cal and California Work Opportunity and Responsibility to Kids. In these two programs, the differences in our estimates of "baseline" costs (that is, excluding discretionary spending) are roughly \$900 million and \$800 million, respectively.
- **Very Similar Revenue Estimates.** After accounting for reserve deposits and reimbursements from the federal government, our estimates of revenues over the budget window are only \$1.7 billion lower than the administration's January estimates. Given that both our office and the administration revised revenue estimates upward by tens of billions of dollars, these figures are very similar.

GOVERNOR'S PROPOSAL FOR ALLOCATING THE GENERAL FUND WINDFALL

How the Governor Allocates the Windfall.

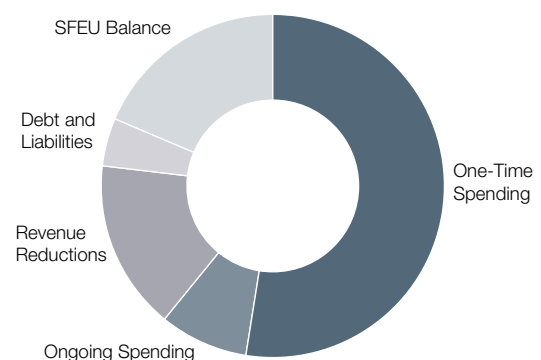
Figure 2 shows how the Governor proposes the Legislature allocate the \$15.5 billion windfall. Specifically, the Governor proposes allocating:

- **\$8.1 Billion to One-Time or Temporary Spending.** The Governor proposes spending just over half of discretionary resources, or \$8.1 billion, on a one-time or temporary basis for a variety of programmatic expansions. (We define temporary to mean three years or fewer.)
- **\$2.9 Billion to the SFEU Balance.** The Governor proposes the Legislature enact a year-end balance in the SFEU of \$2.9 billion. While the Legislature could set this fund balance to any amount greater than zero, in recent years, the Legislature has enacted balances in the SFEU around \$1.5 billion or more.

- **\$2.5 Billion to Revenue Reductions.** The Governor proposes using \$2.5 billion, about 15 percent of the windfall, to reduce revenues.

Figure 2

How the Governor Allocates a \$15.5 Billion Windfall



SFEU = Special Fund for Economic Uncertainties.

LAO

Nearly all of this total would provide a \$600 tax refund to low-income taxpayers.

- **\$1.3 Billion to Ongoing Spending Increases.** The Governor's spending proposals include \$1.3 billion in ongoing spending, slightly less than 10 percent of the windfall. (We estimate the costs of these proposals would grow slightly over time, totaling \$1.4 billion by 2024-25.)
- **\$700 Million to Repay Debts and Liabilities.** In addition to \$3 billion in constitutionally required debt payments, the Governor proposes the Legislature use \$700 million in discretionary resources to repay state debts and liabilities. This includes repaying some special fund loans made in 2020-21 and an additional payment to the California teachers' pension system.

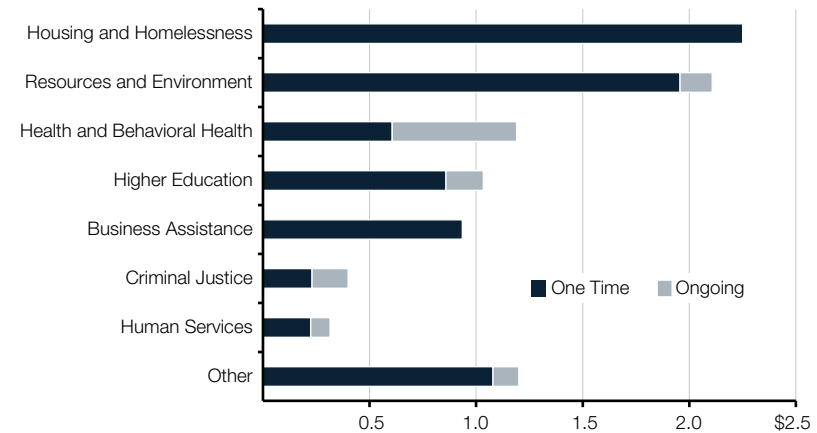
How the Governor Allocates the Windfall by Program Area

Area. Figure 3 shows how the \$15.5 billion in spending proposals are distributed across major program areas. (School and community college spending is excluded from this figure because it is constitutionally required and, therefore, not discretionary.) The largest one-time spending proposals are for housing and homelessness, as well as natural resources and the environment. In these areas, the Governor proposes spending \$2.3 billion and \$1.9 billion on one-time or temporary purposes, respectively. The Governor focuses ongoing amounts on health and behavioral health. As Figure 4 shows, the Governor distributes

Figure 3

How the Governor Allocates the \$15.5 Billion Windfall by Program Area

(In Billions)

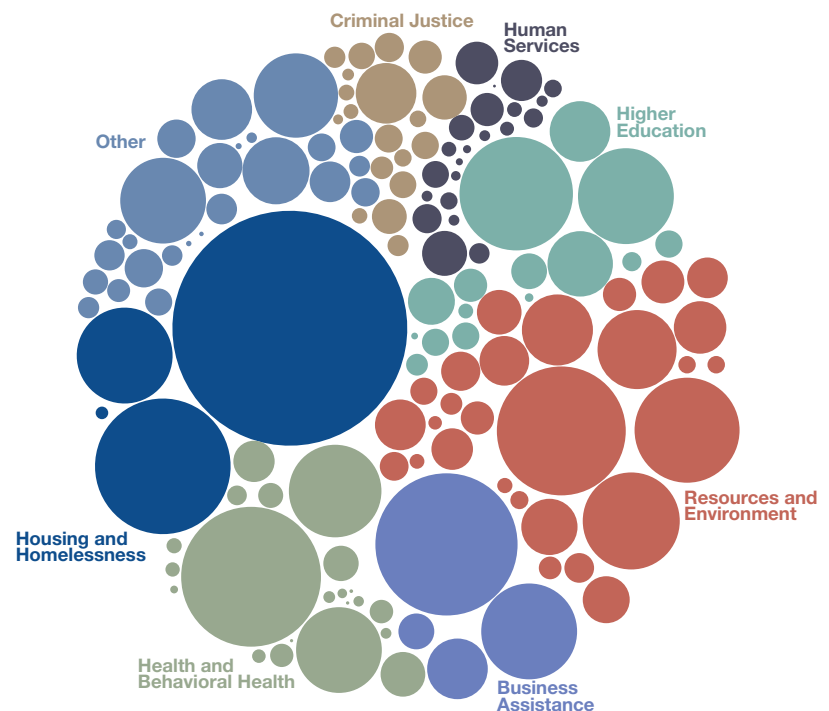


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Figure 4

How the Governor Proposes Allocating the Windfall Among Spending Proposals

\$15.5 Billion General Fund



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the \$15.5 billion windfall over 150 proposals. (The Appendix itemizes these proposals by program area.)

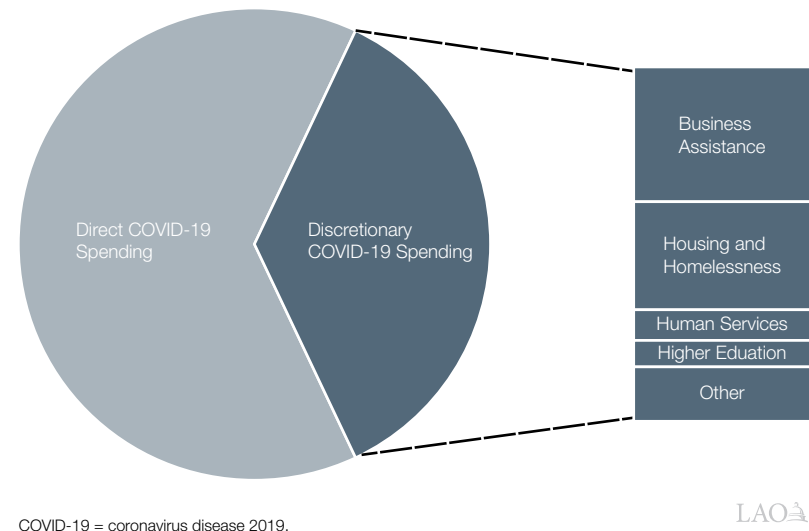
Governor Allocates \$2.5 Billion of the Windfall to Discretionary COVID-19-Related Spending.

In addition to the new \$4.4 billion in direct COVID-19 expenditures included in the Governor's budget, the administration proposes an additional \$2.5 billion in discretionary COVID-19 spending. (Discretionary COVID-19 expenditures include funding allocated to respond to the secondary effects of the pandemic, for example, funding for business assistance.) **Figure 5**, shows how the Governor's Budget distributes discretionary COVID-19 spending among program areas. In addition to the amounts shown in the figure, more than \$7 billion of the Governor's Proposition 98 proposals are directly related to COVID-19.

Governor Proposes \$12.8 Billion for Immediate or Early Action. The Governor proposes the Legislature take immediate or early action on \$12.8 billion in spending or

Figure 5

How the Governor Allocates COVID-19-Related Spending



revenue reductions (see **Figure 6** on page 8). This includes \$2.4 billion in spending using the windfall, \$6.7 billion in school and community college spending, \$2.4 billion in tax refunds, and \$1.4 billion in spending from special funds. The largest of the early action proposals using the windfall are \$550 million for small business grants and \$250 million for funding to continue the Homekey program.

MAJOR BUDGET PROPOSALS

This section describes the major budgetary proposals included in the Governor's budget. We include General Fund proposals (both within Proposition 98 and non-Proposition 98), as well as large spending proposals for special funds and bond funds.

Tax Reductions and Business Assistance

Tax Refunds to Low-Income Californians. The Governor's budget proposes a one-time \$600 tax refund to taxpayers who received the California Earned Income Tax Credit (EITC) for 2019 and taxpayers using an Individual Taxpayer Identification

Number (ITIN) who will receive the EITC for 2020. The refund payments would begin in February 2021. The Governor's budget assumes a cost of \$2.4 billion in 2020-21 for these refunds.

LAO Comment: Legislature Could Consider Alternative Targeting of Refunds. Prior to the pandemic, many of California's low-income workers struggled to cope with the state's high cost of living. The pandemic has exacerbated this problem, as job losses have fallen disproportionately on low-wage workers. In light of this, the Governor's proposal to target relief to low-income Californians makes sense. The Legislature, however, could consider alternative ways to target this relief. Over the last year, most low-income Californians received

Figure 6

Spending Increases and Revenue Reductions Proposed for Immediate and Early Action

(In Millions)

Program/Department	Proposal	2020-21	2021-22	Total	Immediate
General Fund Windfall Spending					
GO-Biz	Small business grants, second round	\$550	—	\$550	X
GO-Biz	New grant program	250	—	250	
Housing and Community Development	Funding to continue Homekey program	250	—	250	
Housing and Community Development	Funding for housing-related infrastructure	250	—	250	
CalFire	Wildfire and forest resilience package	61	\$195	256	
California Student Aid Commission	Cal Grant A eligibility change	58	58	116	
BSCC	Enhanced probation services for adults and juveniles	50	—	50	
GO-Biz	Forest resilience funding	47	—	47	
Alcoholic Beverage Commission	License Renewal Fee Waiver	45	—	45	X
GO-Biz	Grants to entrepreneurs	35	—	35	
Department of Water Resources	Sustainable groundwater management grants	30	30	60	
Board of Barbering and Cosmetology	License Renewal Fee Waiver	26	—	26	X
GO-Biz	Cultural institutions grants	25	—	25	X
California Workforce Development Board	Expand existing apprenticeships	25	—	25	
Department of Conservation	Wildfire and forest resilience package	25	60	85	
Office of Emergency Services	Home Hardening and Community Protection	22	—	22	
Department of Food and Agriculture	State Water Efficiency and Enhancement Program grants	20	20	40	
Sierra Nevada Conservancy	Wildfire and forest resilience package	20	50	70	
Department of Parks and Recreation	Wildland firefighting research grant	10	75	85	
Department of Fish and Wildlife	Wildfire and forest resilience package	9	36	45	
Arts Council	California Creative Corps Pilot Program	5	10	15	
Tahoe Conservancy	Wildfire and forest resilience package	1	11	12	
Aging and Disability Connections	Increase funding to ADRC centers	—	3	3	
Totals, General Fund Windfall Spending		\$1,814	\$548	\$2,362	
Schools and Community College Spending (General Fund)					
Department of Education	Expanded learning and academic intervention	\$4,557	—	\$4,557	
Department of Education	In-person instruction grants	2,000	—	2,000	X
California Community Colleges	Emergency student financial aid	100	—	100	
California Community Colleges	Student retention and enrollment strategies	20	—	20	
Totals, Schools and Community Colleges		\$6,677	—	\$6,677	
Revenue Reductions (General Fund)					
Revenue-related proposal	Low-income tax refunds	\$2,400	—	\$2,400	X
Revenue-related proposal	California Competes tax credits	—	\$10	10	
Totals, Revenue Reductions		\$2,400	\$10	\$2,410	
Special Fund Spending					
Various	Cap-and-trade expenditure plan	\$624	\$745	\$1,369	
CalRecycle	Beverage container recycling pilots	5	5	10	
Totals, Special Fund Spending		\$629	\$750	\$1,379	
Total Early and Immediate Action Proposals		\$11,520	\$1,308	\$12,823	

Note: This table reflects our best understanding of the administration's immediate and early action proposals as of January 10, 2021. However, we continue to receive information from the administration.

GO-Biz = Governor's Office of Business and Economic Development; CalFire = California Department of Forestry and Fire Protection; BSCC = Board of State and Community Corrections; ADRC = Aging and Disability Resource Connection; and CalRecycle = California Department of Resources Recycling and Recovery.

two federal stimulus checks totaling \$1,800 per adult and \$1,100 per child. One exception is Californians who use an ITIN to file their taxes, who were not eligible for the federal programs. Given this, the Legislature could consider more narrowly targeting the Governor's proposal to focus assistance on ITIN taxpayers. For example, our preliminary estimates suggest providing a refund of \$1,800 per adult to ITIN taxpayers with incomes below \$75,000 (a similar threshold to the federal program) would have a similar cost to the Governor's proposal.

Expansion of Tax Incentives. The Governor's budget proposes one-time increases of several existing tax credits and exclusions:

- **Affordable Housing.** \$500 million for tax credits to builders of rental housing affordable to low-income households. (This is the third consecutive year in which the Governor has proposed a one-time expansion of the state's housing tax credit, for a total of \$1.5 billion in tax credits. As with the prior expansions, up to \$200 million would be available for the development of mixed-income housing projects.)
- **California Competes.** \$180 million for California Competes to award tax credits aimed at attracting or retaining businesses in California.
- **Hiring Credit.** \$100 million for tax credits to smaller businesses that increase their number of employees.
- **Sales Tax Exemption.** \$100 million for sales tax exclusions awarded by the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) on purchases of equipment for certain manufacturing activities.

Taxpayers would claim these tax credits and exclusions over a number of years beginning in 2020-21. The Governor's budget assumes these proposals would reduce General Fund revenues by \$76 million in 2020-21 and \$30 million in 2021-22.

Expands One-Time Grants to Various Entities. The Governor's budget includes several one-time proposals to provide assistance to businesses:

- **Small Business Grants.** \$550 million to double the size of a recently created program that awards grants up to \$25,000 to businesses and nonprofits with revenues under \$2.5 million that were impacted by the pandemic.
- **Other Business Grants.** \$250 million for California Competes to provide grants to businesses in addition to its traditional tax credits.
- **Fee Waivers.** \$71 million to waive some of the fees paid by certain professionals and businesses disproportionately affected by the pandemic, such as manicurists and small restaurant owners.
- **Other.** \$135 million for a variety of other grant and loan programs aimed at helping small businesses, with a focus on those from underserved communities. Also, the budget provides \$25 million to the Governor's Office of Business and Economic Development for cultural institutions.

LAO Comment: Some Proposals Raise Concerns. The Governor's proposals to expand California Competes (both tax incentives and grants) and CAEATFA raise a number of concerns: (1) we previously noted issues with the effectiveness of [California Competes](#) and [CAEATFA exclusion](#), (2) these programs are not well targeted to businesses impacted by the pandemic, and (3) businesses would realize the financial benefits more slowly than alternatives such as cash grants. (For our previous analysis of California Competes see: *Review of the California Competes Tax Credit*. For our previous analysis of the CAEATFA exclusion see: *Evaluation of a Sales Tax Exemption for Certain Manufacturers*.)

Schools and Community Colleges

More Than \$19 Billion in New Spending Proposals. Proposition 98 (1988) establishes a minimum annual funding level for schools and community colleges commonly known as the minimum guarantee. Due to increases in the minimum guarantee over the 2019-20 through 2021-22 period (see the box on page 11), the state has \$19.1 billion available for new spending on

K-14 programs. The Governor proposes to spend most of this amount on three main priorities:

- ***Paying Down Deferrals (\$8.4 Billion One Time)***. The June 2020 budget plan deferred \$12.5 billion in payments to schools and community colleges. The Governor proposes to pay down \$8.4 billion of this amount, with districts receiving the associated cash in 2021-22. Slightly more than \$4 billion would remain deferred from 2021-22 to 2022-23.
- ***Providing In-Person Instruction and Expanding Academic Support (\$6.6 Billion One Time)***. The Governor proposes immediate action to provide \$2 billion in one-time grants to incentivize schools to offer in-person instruction for younger students and students with high needs, potentially as soon as February 16, 2021. To receive this additional funding, school districts must (1) develop or update a school reopening plan consistent with updated guidance from the California Department of Public Health, including a plan for asymptomatic testing of all students and staff potentially as often as every week, and (2) approve collective bargaining agreements to implement the new school reopening plan by February 1. (Districts could receive somewhat lower grant amounts if they meet these requirements one month later.) The Governor also proposes early action to provide schools with \$4.6 billion in grants to offer additional academic support for disadvantaged students, which could include summer school, longer school days, community learning hubs, and other locally developed interventions.
- ***Funding Cost-of-Living Adjustments (COLA) (\$2.2 Billion Ongoing)***. Most of the ongoing funding in the Governor's budget is allocated for covering a 3.84 percent COLA for the Local Control Funding Formula. This COLA rate reflects the estimated statutory COLA for 2021-22 (1.5 percent) plus the compounded value of the COLA the state did not provide in 2020-21. For other education programs, including community college

apportionments, the budget provides only the 1.5 percent COLA.

LAO Comment: Budget Reflects a Reasonable Mix of One-Time and Ongoing Spending.

Of the new spending specifically attributable to 2021-22, the budget allocates \$2.6 billion for ongoing commitments and \$2.9 billion for one-time activities. This one-time spending, combined with a \$2.4 billion one-time deposit into the Proposition 98 Reserve (discussed in the nearby box), creates a budget cushion of \$5.3 billion. This cushion helps protect ongoing programs from volatility in the minimum guarantee. Specifically, to the extent the guarantee drops or grows more slowly in the future, the expiration of these one-time allocations allows the state to accommodate the lower guarantee without relying on program cuts or payment deferrals. Having a large one-time cushion seems especially important in 2021-22 given the continued and significant economic uncertainty due to the pandemic. Moreover, \$2.3 billion of the total Proposition 98 funding allocated to schools in 2021-22 is supported with a one-time supplemental payment (the Governor's budget assumes no such additional payments are provided after 2021-22).

LAO Comment: Concerns With Feasibility of In-Person Instruction Proposal. Given the short time frame and significant steps schools would be required to take, we are concerned the proposal for offering in-person instruction is likely unfeasible and could discourage school district participation. To be open by February 16, schools would only have a few weeks to complete their reopening plans, arrange routine testing, and develop collective bargaining agreements with their labor unions. It is also unclear whether the state and local health departments have the capacity to provide the support and technical assistance necessary to help schools implement their reopening plans in such a short time frame. The Legislature will want to consider whether the proposal provides sufficient time for planning and whether the schools and public health agencies have the capacity to effectively implement the requirements under the time lines specified. To address these concerns, the Legislature could, for example, modify the proposal to first offer in-person instruction to all high-needs students a month before bringing back

all younger students. This would allow time for schools to ramp up testing capabilities and address other implementation issues with a smaller group of students and staff. Alternatively, the Legislature could direct resources to expanding statewide testing capacity and infrastructure that would allow schools to more easily access routine testing as a way to support school reopening. However, doing so by February 16 may be difficult.

LAO Recommendation: Allocate Greater Share of Funding to Paying Down Deferrals and Addressing Pension Cost Increases. School districts report a number of costs associated with responding to the COVID-19 pandemic and preparing to resume in-person instruction. Examples include purchasing devices and internet

connectivity for distance learning, cleaning and reconfiguring facilities, training teachers, and testing for the virus. However, the 2020-21 budget allocated more than \$7 billion in state and federal funds to address COVID-19-related costs and mitigate learning loss. Recent federal legislation—approved shortly before the release of the Governor’s budget—is likely to provide a similar amount of one-time funding in 2021-22. Although some additional state funding directed toward academic support and reopening schools might be warranted, we think the budget misses an opportunity to make more progress on two other issues. Specifically, we recommend the Legislature allocate a larger share of the one-time funds for (1) paying down deferrals or (2) mitigating future

Changes in the Proposition 98 Guarantee Under the Governor’s Budget

Substantial Upward Revisions to Estimates of the Minimum Guarantee. Each year, the state calculates the minimum guarantee using a set of formulas in the State Constitution. The guarantee encompasses state General Fund revenue as well as local property tax revenue. Compared with the estimates in the June 2020 budget plan, the administration revises its estimates of the guarantee up \$1.9 billion (2.4 percent) in 2019-20 and \$11.9 billion (16.8 percent) in 2020-21. For 2021-22, the guarantee is up an additional \$3 billion (3.6 percent) relative to the revised 2020-21 level. In addition, a law enacted last June requires the state to make a \$2.3 billion supplemental payment on top of the guarantee in 2021-22. Including this payment, total Proposition 98 funding for schools and community colleges in 2021-22 is \$88.1 billion—\$60.8 billion from state General Fund and \$27.3 billion from local property tax revenue.

Budget Proposes Eliminating Supplemental Payments After 2021-22. When the state created the requirement for supplemental payments, it had anticipated a steep drop in the minimum guarantee that would affect school and community college funding for several years. The supplemental payments were intended to accelerate the recovery from this drop, with payments growing from \$2.3 billion in 2021-22 to more than \$6 billion by 2024-25. Due to the strong rebound in the minimum guarantee, the Governor proposes to eliminate these payments after 2021-22—effectively making the \$2.3 billion included in the 2021-22 budget a one-time payment.

Proposition 98 Reserve Deposits Required in 2020-21 and 2021-22. Proposition 2 (2014) established the Proposition 98 Reserve and set forth rules requiring deposits and withdrawals under certain conditions. Generally, the state is required to deposit Proposition 98 funding in this account when revenue from capital gains is relatively strong and the minimum guarantee is growing faster than per capita personal income. The administration estimates the state is required to make a \$747 million deposit in 2020-21 and a \$2.4 billion deposit in 2021-22. The total balance of the reserve would be \$3 billion, which equates to about 3.5 percent of all funding that would be allocated to schools and community colleges in 2021-22.

cost increases related to pensions. Paying down deferrals would better position districts and the state to weather economic volatility by reducing pressure on future Proposition 98 budgets. Paying down future pension costs could help smooth out a notable increase in costs currently projected for 2022-23. Although taking these actions might mean somewhat less one-time funding is available for new programs in 2021-22, we think they would increase the likelihood that the programs districts do develop in the coming year can be sustained over time.

Universities

Governor Proposes Ongoing Base Increases Linked With Certain Expectations. The Governor proposes a total of \$336 million in additional ongoing funding for the California State University (CSU) and the University of California (UC). The largest ongoing proposals for the universities are 3 percent General Fund base increases (\$112 million for CSU and \$104 million for UC). The Governor links these base increases to CSU and UC meeting three expectations: (1) developing a plan to eliminate their achievement gaps by 2025, (2) permanently increasing the share of courses they offer online by at least 10 percentage points over their pre-pandemic levels, and (3) establishing “dual admissions” pathways designed to simplify and expedite student transfer from community colleges to CSU and UC. The Governor also expects the universities to improve the alignment of their courses and programs with workforce needs. Additionally, he expects the segments to keep their tuition flat at 2020-21 levels. Consistent with his budget approach the past few years, the Governor sets no enrollment growth expectations for CSU or UC. Beyond the base increases, the Governor proposes ongoing augmentations for several student support programs, including student basic needs and mental health.

One-Time Proposals Focus on Maintenance and COVID-19 Relief. The Governor proposes a total of \$450 million in one-time funding for the universities. The largest one-time initiatives are \$175 million each for CSU and UC, with both segments able to use the funds for deferred maintenance and UC also able to use the funds

explicitly for energy efficiency projects. Other notable one-time proposals focus on emergency student financial aid and faculty professional development, with the intent to help students and faculty navigate some of the challenges associated with the pandemic and remote instruction. Though unknown at the time of the Governor’s budget development, the administration is estimating that California will receive roughly \$2.9 billion in additional one-time higher education support from the new round of federal relief funding. A portion of the \$2.9 billion would go to CSU and UC, which they could use for emergency student financial aid as well as various institutional purposes (such as addressing revenue losses in their housing programs and covering higher COVID-19-related technology and professional development costs).

LAO Comment: Governor’s University Package Is Reasonable Starting Point... We think the outline of the Governor’s budget package for the universities is reasonable. It provides additional funding for base operations to partly address the reductions the state enacted last year. The Governor’s expectations for additional base funding also are generally in line with legislative priorities the past several years (though the Legislature could consider expressing other expectations, for example, on enrollment growth). The budget package designates more new funding to one-time than ongoing purposes, not further exacerbating the state’s projected operating deficit over the next few years. It also designates the bulk of one-time spending for maintenance and energy efficiency projects—helping address existing backlogs while avoiding more costly future repairs and potentially having some modest economic stimulus effect.

...But Some Components Could Be Reconsidered. The Legislature might want to revisit some of the specific proposals in the Governor’s higher education package. If it were to decide to put additional ongoing funding into student support programs, we recommend the Legislature consider several fundamental policy issues, including crystallizing overarching objectives, measuring unmet need, linking funding levels and allocations with unmet need, and tracking progress toward meeting objectives. The Legislature also could evaluate most, if not all,

of the Governor's one-time proposals (beyond the facility proposals) in light of the new federal relief package, which has funding for the same purposes. Lastly, as lower-income students (those most affected during these times) receive full tuition coverage at the public universities and campuses generally are on track to resume in-person operations for the 2021-22 academic year, the Legislature could reconsider having the universities keep tuition levels flat. Raising tuition would increase overall budget capacity, allowing more state priorities to be addressed, including potentially supporting more or better university services.

Housing and Homelessness

Key Homelessness Proposals. The Governor proposes \$1.75 billion one-time General Fund for various programs related to homelessness.

- **Homekey Continuation.** The Governor proposes \$750 million to continue the Homekey Program administered through the Department of Housing and Community Development (HCD). Over \$800 million in one-time funding (all funds) was provided to the newly established Homekey Program in 2020-21. The program allows for the acquisition and rehabilitation of hotels, motels, vacant apartments, and other properties that could be used to provide permanent housing for persons experiencing homelessness or at risk of homelessness, and who are impacted by COVID-19. HCD provides Homekey grants to local governments to acquire these properties, which are owned and operated at the local level. The administration indicates that the existing Homekey funding will create over 6,000 housing units for individuals and families. Of the \$750 million, the Governor requests early action from the Legislature to authorize \$250 million in 2020-21.
- **Behavioral Health Infrastructure.** The Governor proposes \$750 million for the Department of Health Care Services (DHCS) to provide grants to counties for the acquisition and rehabilitation of properties to expand behavioral health treatment resources.

The administration estimates this proposal would produce at least 5,000 beds to treat persons with behavioral health disorders. (This proposal is also discussed in the health and behavioral health section of this report.)

- **Expanded Facilities to Support Housing.**

The Governor proposes \$250 million for the acquisition and rehabilitation of Adult Residential Facilities and Residential Care Facilities for the Elderly with a focus on preserving and expanding housing for low-income seniors who are experiencing homelessness or are at risk of homelessness. The Department of Social Services (DSS) would administer the program and provide grants to local governments.

Funding for Housing-Related Infrastructure.

The Governor proposes \$500 million one-time General Fund to the Infill Infrastructure Grant (IIG) program administered by HCD. This program helps to fund housing-related infrastructure such as building site remediation, sewers, and roads. Of the \$500 million, the Governor requests early action from the Legislature to authorize \$250 million in 2020-21. This proposal adds to the \$300 million General Fund recently provided for IIG.

Eviction Protections. The Governor proposes \$11.7 million one-time General Fund to trial courts for the implementation of the Tenant, Homeowner, and Small Landlord Relief and Stabilization Act of 2020 (Chapter 37 of 2020 [AB 3088, Chiu]). Under the legislation, no tenant can be evicted before February 1, 2021 because of rent owed due to a COVID-19-related hardship experienced between March 4 and August 31, 2020, if the tenant provides a declaration of hardship. The law also specifies that for a COVID-19-related hardship that occurs later—between September 1, 2020 and January 31, 2021—tenants must pay at least 25 percent of their rent due to avoid eviction. Tenants are still responsible for paying unpaid rents to landlords, but those unpaid amounts cannot be the basis for an eviction. Under the legislation, landlords may pursue such unpaid rent in small claims filings. The administration anticipates an increase in eviction cases (known as unlawful detainers) and small claims filings when

the statutory protections expire, resulting in new workload for trial courts. The Governor requests early action from the Legislature to authorize the entire \$11.7 million in 2020-21 in anticipation of the increased workload. Lastly, the budget also identifies the Governor's desire to extend the eviction protections in AB 3088 past January 31, 2021. The budget proposal does not provide details about an extension of the eviction moratorium.

LAO Comments: Governor Continues to Rely on One-Time Solutions. While the Governor's budget reflects his commitment to curbing homelessness and addressing housing affordability by once again proposing significant state resources toward these issues, the Governor's response continues to focus on one-time solutions. As we have said previously, a clear, long-term strategy would make it more likely that the state's investments would have a meaningful ongoing impact on its housing and homelessness challenges. In addition, several of the Governor's proposals focus on the acquisitions and rehabilitation of properties using one-time resources. Moreover, whether the Governor's proposals provide funding for supportive services and maintenance is unclear. Lastly, it is unclear how the administration would target the resources administered by DHCS and DSS to address homelessness. It is possible that addressing homelessness will not be the principal benefit of these proposals.

Health and Behavioral Health

Budget Reintroduces the California Advancing and Innovating Medi-Cal (CalAIM) Proposal. As a part of the January 2020-21 budget, the Governor proposed a large number of Medi-Cal reforms collectively known as CalAIM. With this proposal, the Governor aimed to: (1) provide a more comprehensive suite of services to high-risk, high-need Medi-Cal beneficiaries (such as transitional housing services to protect against homelessness); (2) standardize and streamline Medi-Cal managed care; (3) extend programs and the associated federal funding for Medi-Cal currently authorized under temporary waiver authority; and (4) rethink how mental health and substance use services are delivered and

financed. Given the state's fiscal situation, CalAIM was withdrawn at the 2020-21 May Revision. The Governor's 2021-22 budget reintroduces CalAIM in a broadly similar, but more developed, form. (Consultation with stakeholders took place after the proposal's initial introduction.) To implement key components of the proposal beginning in January 2022, the Governor proposes to spend \$1.1 billion total funds (\$531.9 million General Fund) in 2021-22, and \$864 million total funds (\$423 million General Fund) on an ongoing annual basis.

LAO Comment: Legislative Considerations Regarding the CalAIM Reforms. In concept, CalAIM reflects a promising package of reforms to bolster, streamline, and transform care delivery in Medi-Cal. At the same time, the CalAIM proposal is complex and far-reaching. While the stakeholder process leading up to the proposal was robust, the onset of COVID-19 obstructed the Legislature's opportunity to ask questions about the proposal and provide input. Accordingly, we suggest the Legislature use the upcoming budget process to:

- **Learn More About How This Year's CalAIM Proposal Differs From the Prior Year's.** This year's CalAIM proposal differs from the prior year's proposal in many ways. For example, the implementation time line is revised. Also, whereas last year the administration announced it was exploring whether to pursue a new federal funding opportunity for residential services for individuals with mental illness, the current proposal announces an intent to pursue this opportunity. Additionally, the current proposal expands the list of nontraditional Medi-Cal benefits that may be offered to enrollees to include asthma remediation services.
- **Resolve Key Outstanding Questions About the Proposal.** While the Governor released extensive documentation with the updated CalAIM proposal, whether this information answers key outstanding questions is unclear. For example, how would the administration implement and continue to refine CalAIM in coordination with other major statewide planning initiatives, including the Master Plan for Aging, the Behavioral Health Task

Force, and other state efforts related to homelessness?

- **Weigh the Potential Benefits and Risks Presented by This Complex Reform Package.** CalAIM presents both benefits and risks for Medi-Cal beneficiaries, providers, and policymakers. For example, transitioning Medi-Cal beneficiaries and benefits into and out of managed care—there are CalAIM proposals in each of these two directions—often brings short-term disruptions even if long-term improvements are likely to materialize.
- **Identify Components That May be Missing From the Governor’s Proposal.** The CalAIM proposal reflects the administration’s priorities for how to transform Medi-Cal. The Legislature could consider whether it has additional—or different—priorities for transforming Medi-Cal and whether any components may be missing from the Governor’s proposal, such as requirements for robust evaluation and oversight.

Budget Includes Several Major Behavioral Health Proposals. The Governor’s budget includes several major proposals to address behavioral health needs statewide. These include:

- **\$750 Million to Strengthen County “Behavioral Health Continuum.”** As described earlier, the Governor proposes \$750 million General Fund—made available over three years—for competitive grants to counties to purchase or renovate real estate for behavioral health facilities. Counties would be required to provide matching funds to receive these grants.
- **\$400 Million to Provide Student Behavioral Health Services Through Medi-Cal.** The Governor proposes \$400 million total funds (\$200 million General Fund)—made available over three years—to incentivize Medi-Cal managed care plans to establish treatment partnerships with county behavioral health departments and schools.
- **\$233 Million for Counties to Treat Felony Incompetent-to-Stand-Trial (IST) Patients.** The Governor proposes \$233 million General

Fund—of which \$136 million is ongoing—for a demonstration project in which counties would treat felony IST patients instead of the Department of State Hospitals. This proposal is similar in purpose to a rescinded proposal from last year’s Governor’s budget, but structured differently.

- **Potential Redirection of Jail Bonds for Community Mental Health Facilities.** The Governor has expressed interest in redirecting unused jail bonds to purchase or renovate community mental health facilities. According to the administration, about \$202 million could be made available for this purpose.

LAO Comments: Legislative Considerations for Behavioral Health Proposals. First, the Legislature may wish to consider whether counties have the capacity to increase their funding for behavioral health to meet the Behavioral Health Continuum grant proposal’s match requirement without reducing existing services. Second, in considering the student behavioral health proposal, the Legislature may wish to ask the administration whether Medi-Cal managed care plans would have the capacity to meet the requirements to receive the incentive payments given the significant added responsibilities they may receive under the administration’s CalAIM proposal. Finally, the Legislature also may wish to ask the administration why it is proposing *ongoing* funding for the county felony IST demonstration project, rather than waiting until the demonstration project’s effectiveness can be evaluated to make this funding decision.

Environment, Natural Resources, and Disaster Preparedness

Zero-Emission Vehicles (ZEVs) and Infrastructure. The Governor’s budget includes three proposals that would provide a total increase of up to \$1.5 billion (various funds) to promote ZEVs. First, the budget includes up to \$1 billion (Alternative and Renewable Vehicle and Fuel Technology Fund) to support new ZEV fueling infrastructure. The funding would come from extending various vehicle-related charges (such as a portion of vehicle registration fees) set to expire

in 2024 and using some of the future revenue to issue revenue bonds. Second, the budget includes \$465 million from the Greenhouse Gas Reduction Fund (GGRF)—\$239 million in the current year and \$226 million in the budget year—for (1) heavy-duty ZEV incentives and (2) light-duty ZEV incentives for low-income households in disadvantaged communities. Third, the budget includes \$50 million one time from the General Fund to support ZEV charging stations at state-owned facilities.

LAO Comments: Legislative Considerations in Reviewing ZEV Package. These proposals would continue efforts to meet the Legislature's greenhouse gas reduction goals, as well as support the Governor's ZEV goals established in a recent executive order. In reviewing the proposals, there are many different issues for the Legislature to consider, including (1) whether the proposals are likely to be the most effective set of policies and programs to promote ZEVs and achieve the state's climate change and air quality goals; (2) how these state programs will be integrated or coordinated with existing programs, such as ZEV programs administered by electric utilities; (3) how the administration intends to balance efficiency and equity considerations in the allocation of funding for ZEV infrastructure and vehicles; and (4) whether issuing bonds—rather than continuing a pay-as-you-go approach—is the most appropriate funding mechanism for the proposed activities.

Disaster Response and Preparedness.

In addition to the COVID-19-related spending proposals discussed earlier, the Governor's budget includes numerous proposals related to responding to and preparing for disasters. (The budget also assumes total additional state spending in 2020-21 of over \$3 billion—including a net General Fund increase of \$1.3 billion after accounting for federal reimbursements—for response and recovery activities related to the 2020 wildfires.) Some of the major proposals include:

- **Wildfire Resilience and Forest Health.**

The Governor's budget proposes a total of \$1 billion—\$323 million in 2020-21 and \$677 million in 2021-22—for 15 departments to implement various efforts related to improving forest health and making communities more resilient to future

wildfires. The total includes \$675 million from the General Fund and \$325 million from GGRF. Given the severity of wildfires in recent years, it is reasonable to consider additional spending on wildfire prevention and mitigation activities. In comparison, most budget augmentations in recent years have focused on building the state's wildfire response capacity. In reviewing the proposed package, it will be important to evaluate the relative effectiveness of each proposal at improving wildfire safety and, in turn, whether funding the particular mix of programs would be the most effective way to spend the total funding ultimately provided. In addition, all of the proposed General Fund augmentations are one time, but the Legislature might want to consider whether certain programs should operate on an ongoing basis to address what is a long-standing wildfire risk in many areas of the state.

- **California Disaster Assistance Act (CDAA) Funds.**

The administration proposes \$256 million one time from the General Fund to assist local governments with emergency response and recovery through CDAA—a \$155 million increase over the amount budgeted for 2020-21. CDAA funding is used to (1) restore or replace public real property damaged during disasters or (2) reimburse local governments for eligible emergency response costs. Local governments are typically responsible for 25 percent of the eligible costs under CDAA, with the state covering the remaining 75 percent.

- **Flood Management.**

The proposed budget includes \$67 million from the General Fund in 2021-22, plus an additional \$158 million over the subsequent three years, to fund the state's share of a large federal flood risk reduction project along the American River. The Governor also proposes \$75 million one time from the General Fund for deferred maintenance on levees in the Central Valley, as well as about \$140 million from Propositions 1 (2014) and 68 (2018) for various other flood-related projects and initiatives.

- **Disaster Response Emergency Operations Account (DREOA) Authority Extension.** The authority the administration uses to access funds in DREOA for pandemic-response is set to expire at the end of 2020-21. The administration proposes extending its authority to access DREOA for pandemic response through control section language (C.S. 11.92) in the 2021-22 budget. In reviewing the language, the Legislature will want to consider whether it allows for sufficient legislative oversight of pandemic response expenditures given the critical nature and magnitude of these expenditures.

Clean Up of Contaminated Sites. The Governor's budget includes \$300 million one time from the General Fund in 2021-22 for the Department of Toxic Substances Control (DTSC) to clean up contaminated properties. The amount proposed would be allocated for cleanup and investigation activities at sites across the state according to risk-based criteria. The administration states that the proposed funding would be contingent upon the enactment of the Governor's proposed governance and fiscal reform package

for DTSC, which includes creation of an oversight board and changes to the charges that support DTSC's two major special funds.

LAO Comments: DTSC Proposal Has Merit, but Lacks Important Details. We find that the proposals have merit given a backlog of contaminated sites, the potential for an oversight board to increase transparency and accountability, and the structural deficits of the two affected funds. However, certain details will be important for the Legislature to evaluate each proposal. For instance, additional information is needed on the specific criteria DTSC will use to prioritize the \$300 million and the specific projects that will be selected. In addition, while the funding is proposed as one time, it is unclear if there will be ongoing costs to maintain and operate implemented projects. The specific statutory language to establish the board and change the structure of charges also will be important. For example, the Legislature will want to consider whether the proposal fairly assigns costs to payers that should bear the fiscal burden, as well as whether the charges can be adjusted in future years to address inflation or other cost increases in order to avoid future structural deficits.

OVERALL LAO COMMENTS

Recent Federal Pandemic Relief

Recent Federal Action Provides Substantial Pandemic Relief Through the Spring... In late December, the federal government passed an additional package of pandemic relief which included lump-sum payments to most taxpayers; expanded unemployment insurance benefits; and provided funding for rental assistance, additional business loans and grants, and schools. The Governor's budget includes a number of significant proposals—many of them proposed as immediate and early actions—that address similar pandemic-related needs. This overlap is understandable given that the final details of the federal package were only known as the administration was cementing its budget proposal.

...Reducing the Urgency of Immediate State Action. Nonetheless, given what we know now, it would be prudent to step back and examine the Governor's proposal in light of new federal relief. The additional federal relief significantly reduces the pressure on the state to act immediately to provide economic assistance to those affected by the pandemic. The scale of the federal actions far outstrips the state's spending capacity. As an example, the Governor's tax refund for low-income Californians costs \$2.4 billion, whereas we estimate the recent federal unemployment benefits expansion will provide another \$20 billion to \$30 billion to Californians impacted by job losses.

State Should Complement Federal Action and Focus on Controlling the Spread of Virus. In light of the recent federal action, we recommend the Legislature: (1) determine how to best target

state funds to those not benefiting from the federal assistance, and (2) strive to complement, rather than duplicate, the federal activities. While the state's capacity to provide economic assistance is much more limited than the federal government, state funding can make a significant difference for public health measures and controlling the virus. As a result, one of the state's most important roles in complementing federal efforts is to restore economic activity by controlling the spread of the virus, for example, through rapid vaccine distribution.

Immediate and Early Action

Immediate Action Proposals. The Governor's budget includes \$5 billion in actions he proposes the Legislature adopt within the next few weeks. These actions are intended to address some of the most pressing issues of the pandemic. As noted earlier, however, some of these issues have been addressed in the near term by the federal relief package passed in December. Below, we summarize our assessment of these proposals and whether immediate action—as proposed—is warranted.

- **School Reopening Time Lines Likely Unfeasible.** Given the short time frame and significant steps schools would be required to take, we are concerned the proposal for offering in-person instruction is unfeasible and likely would discourage school district participation. It also is unclear whether state and local public health agencies have the capacity to support schools on such a short time line. The Legislature will want to consider whether the proposal provides sufficient time for planning and whether the schools and public health agencies have the capacity to effectively implement the requirements under the time lines specified.
- **Tax Refunds for Low-Income Californians Could Be More Targeted.** Some groups, in particular taxpayers who use an ITIN, have not been included in recent federal cash assistance programs. The case for immediate action is strongest with regard to providing income support to these taxpayers.

- **Small Business Assistance Worth Considering.** Recent federal business assistance, while considerably larger than proposed state assistance, is not well targeted to the most impacted businesses. Because of this, immediate state action on the \$550 million for small business grants, which are targeted at impacted businesses, is worth considering. (Taking immediate state action on the \$25 million in cultural institution grants also is worth considering for similar reasons.) Doing so, however, would not give the Legislature a chance to determine how much demand actually exists for this brand new program. Should the grants be approved, the administration should report regularly on their distribution. If funds remain unspent by May Revision, the Legislature should consider reallocating them to more pressing needs.
- **Fee Waivers Reasonable.** Waiving fees for individuals and businesses directly affected by the pandemic and stay-at-home orders is reasonable. Moreover, the Legislature may wish to ask the administration if individuals and business would be reimbursed for fees paid since March 2020. In reviewing the specific proposals, the Legislature will want to consider whether a full General Fund backfill is necessary given the condition of the special funds affected.

In addition, the Governor has indicated interest in taking immediate action on the eviction moratorium, which is set to expire at the end of January. To date, the administration has not provided us with the details of this proposal.

Early Action Proposals. The Governor proposes over a dozen proposals costing \$7.8 billion that he is asking the Legislature to pass in the early spring. A few of these proposals—like academic support for K-12 students and emergency financial aid for community college students—overlap with recent federal action. While a number of proposals increase funding to existing state programs, others are mostly new, like those related to promoting sustainable agriculture. We recommend the Legislature consider each proposal separately and ask a series of consistent questions when

determining whether the proposals warrant early action. Specifically, we recommend the Legislature ask:

- ***Does the Administration Provide Sufficient Evidence of a Problem?*** To make this determination, we suggest the Legislature consider whether the proposal aims to address pressing pandemic-related issues in ways that go beyond federal actions. Moreover, we suggest the Legislature consider whether, absent the pandemic, the proposal would be worth pursuing. If not, we suggest taking more time to review the proposal and its policy goals. For instance, we do not think early action is warranted on the expansion of California Competes, as this proposal is not well targeted to help the most impacted business and also raises many policy questions that deserve thorough consideration. For example, is California Competes' model appropriate for awarding grants? How would the state recoup funding if businesses don't meet their milestones?
- ***Is the Proposal Time Sensitive?*** Specifically, we suggest the Legislature consider whether early action is advantageous. As noted earlier, the recent federal action has reduced the need for urgent action in some areas. What is the overlap of the early action proposals with federal action? Would early state action provide substantial additional benefits? For example, the administration proposes providing \$250 million to expand Project Homekey in early action. Does the administration have a list of properties ready for purchase and renovation? Would early action allow individuals experiencing homelessness move in earlier than they otherwise would?
- ***Is the Entire Funding Amount Time Sensitive?*** Sometimes the administration asks for most or all of the funding associated with a proposal in order to start planning and developing the program. The full cost of the proposal, however, often is incurred later. The Legislature may want to consider whether some early action proposals could

be approved in concept with the final funding amounts determined as part of the final budget package. For example, some funding proposed for early action would not be spent until 2021-22.

- ***Is There Sufficient Detail in the Plan to Assess Its Potential Success?*** By definition, with early action items, the Legislature has less time to understand the proposals, voice its concerns, and ensure necessary changes are incorporated. Consequently, when adopting an early action proposal, the Legislature should have sufficient information from the administration to be reasonably assured the proposal will achieve its stated goals. We recommend weighing whether the advantages of taking early action outweigh any uncertainty as to the proposal's likelihood of success. For instance the state currently does not have an emergency financial aid program for community college students (although it does have traditional financial aid programs for these students). Deciding how to best allocate state emergency financial aid funds could take extra time and deliberation, especially as the Legislature would want to consider how any potential state allocation methods could interact with federal allocation methods.

Ultimately, making decisions with the benefit of knowing how vaccine distribution proceeds, how the economy responds, how revenues perform in the spring, and whether the federal government distributes additional funds to states will be very valuable for determining how to allocate the state's limited resources.

Restoring Budget Resilience

Rebuilding Budget Resilience. The 2020-21 budget addressed a \$54 billion budget problem, which arose as a result of an estimated historic decline in revenues. While those estimates were reasonable at the time, since then, we have learned that they were too pessimistic. This means the state took a number of actions to balance the budget—including making withdrawals from reserves and shifting costs—that were larger

than necessary. In light of that fact, as well as continued economic uncertainty and anticipated future deficits, we think it is important that the state restore most or all of that resilience. The state has two avenues available to do so:

- **Constitutional Requirements.** The administration's interpretation and assumptions result in large constitutionally required reserve deposits and debt repayments. For example, the state would end 2021-22 with \$18.9 billion in reserves, about \$1.6 billion less than the amount proposed under the *2020-21 Governor's Budget*. In addition, the state would be required to dedicate about \$3 billion to debt payments, and the administration proposes using a significant share of this total to pay down unfunded liabilities.
- **Allocating the Windfall.** While the administration does reflect large constitutional reserve deposits and debt payments, the Governor proposes using very little of

the windfall to restore budget resilience. Specifically, the Governor proposes using \$700 million to repay debts and liabilities and sets the balance of the state's discretionary reserve at a somewhat level higher than the one enacted in 2020-21. Otherwise, however, the Governor does not use the windfall to restore the budget's fiscal resilience, which will be important to help the state weather the next downturn.

Addressing the Structural Deficit. Like our office, the administration anticipates the budget faces a multiyear structural deficit. The administration's proposal to eliminate the ongoing supplemental payment to schools and community colleges shrinks the size of these deficits. However, the Governor does not lay out a plan to address the remainder, which is significant and growing over time. We recommend the Legislature begin to consider how the state might address the budget's ongoing problem. For example, using some of the windfall to make supplemental pension payments would reduce the multiyear structural deficit.

CONCLUSION

The pandemic has disrupted the lives and livelihoods of millions of Californians and continues to take the lives of thousands of Californians each month. In the spring of 2020, the Legislature faced an unprecedented challenge to respond to the pandemic and adopt a budget in the face of unprecedented economic uncertainty. Almost ten months into this disaster, the state's fiscal situation is quite different. Revenues are nearly back to

pre-pandemic levels and state costs have not risen as dramatically as anticipated. Moreover, effective vaccines are being administered. While the state still is very much in the midst of this crisis, there is hope on the horizon. The budget process offers the Legislature an opportunity to consider how the state can best use its resources to help California respond and recover.

APPENDIX

Appendix Figure 1

Business Assistance: Discretionary Spending Proposals in the 2021-22 Governor's Budget

(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
GO-Biz	Small business grants, second round	\$550	—	—
GO-Biz	California Competes: new grant program	250	—	—
GO-Biz	Small business finance center	—	\$50	—
GO-Biz	Small business loan guarantee program	—	50	—
GO-Biz	Grants to entrepreneurs	35	—	—
Totals		\$835	\$100	—

GO-Biz = Governor's Office of Business and Economic Development.

Appendix Figure 2

Criminal Justice: Discretionary Spending Proposals in the 2021-22 Governor's Budget

(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
BSCC	Support for county probation departments	\$50.0	—	—
BSCC	Funding for post release community supervision population	—	\$19.5	—
BSCC	COVID-19-related funding for post release community supervision population	—	12.1	—
CDCR	One-time deferred maintenance allocation	—	50.0	—
CDCR	Valley State Prison: Arsenic and Manganese Removal Water Treatment Plant	—	20.3	—
CDCR	California Institution for Men: Air Cooling at Facility A	—	13.9	—
CDCR	Various other proposals	—	19.6	\$45.7
DOJ	Consolidated forensic science laboratory campus	—	6.5	—
DOJ	DNA Identification Fund backfill	—	—	6.0
Judicial Branch	Deferred maintenance	—	30.0	—
Judicial Branch	Courthouse construction and planning studies	—	8.3	—
Judicial Branch	Courthouse facility operations, maintenance, and leases	—	—	53.5
Judicial Branch	Continuation of self-help services funding	—	—	19.1
Judicial Branch	Online adjudication of infractions and ability-to-pay	—	—	12.3
CalVCB	Restitution Fund backfill	—	—	33.0
Totals		\$50.0	\$180.0	\$170.0

BSCC = Board of State and Community Corrections; COVID-19 = coronavirus disease 2019; CDCR = California Department of Corrections and Rehabilitation; DOJ = Department of Justice; and CalVCB = California Victim Compensation Board.

Appendix Figure 3**Health and Behavioral Health: Discretionary Spending Proposals in the 2021-22 Governor's Budget**
(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
CDPH	Alzheimer's and dementia research, awareness, training	—	\$17.0	—
CDPH	Books for low-income children	—	5.0	—
CDPH	Infectious disease (COVID-19) modeling activities	—	0.5	—
CHHS, Secretary	Various proposals	—	7.6	—
EMSA	Various proposals	—	—	\$0.7
Medi-Cal	Provide incentives for student behavioral health	—	200.0	—
Medi-Cal	Reintroduce CalAIM reforms	—	108.9	423.0
Medi-Cal	Expand and make permanent certain telehealth flexibilities	—	34.0	—
Medi-Cal	Add continuous glucose monitoring benefit	—	—	3.8
OSHPD	Increase geriatric workforce	—	3.0	—
State Hospitals	Establish county demonstration project for incompetent to stand trial patients	—	96.8	136.4
State Hospitals	Construction projects	—	54.3	—
State Hospitals	Extend and expand incompetent-to-stand trial diversion pilot program	—	46.4	—
State Hospitals	Deferred maintenance	—	15.0	—
State Hospitals	Various other proposals	\$13.0	5.0	19.2
Totals		\$13.0	\$593.4	\$583.1

CDPH = California Department of Public Health; COVID-19 = coronavirus disease 2019; CHHS = California Health and Human Services Agency; EMSA = Emergency Medical Services Authority; CalAIM = California Advancing and Innovating Medi-Cal; and OSHPD = Office of Statewide Health Planning and Development.

Appendix Figure 4**Higher Education: Discretionary Spending Proposals in the 2021-22 Governor's Budget**
(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
California State University	Deferred maintenance	—	\$175	—
California State University	Emergency student financial aid	—	30	—
California State University	CSU Monterey Bay Computing Talent Initiative	—	10	—
California State University	Faculty professional development	—	10	—
California State University	Student basic needs (Graduation Initiative)	—	—	\$15
California State University	Student basic needs (mental health and technology)	—	—	15
California State University	Other proposals	—	—	3
California Student Aid Commission	Cal Grant A eligibility restoration	\$58	—	58
California Student Aid Commission	Golden State Teacher Grants	—	100	—
California Student Aid Commission	Additional Cal Grant competitive awards	—	—	35
California Student Aid Commission	Cal Grant supplemental awards for foster youth	—	—	20
University of California	Deferred maintenance and energy efficiency projects	—	175	—
University of California	California Institutes for Science and Innovation	—	20	—
University of California	Emergency student financial aid	—	15	—
University of California	Student basic needs (mental health and technology)	—	—	15
University of California	Programs in Medical Education (PRIME)	—	—	13
University of California	Other proposals	—	15	1
Other	Workforce development and higher education linkages	—	250	—
Totals		\$58	\$800	\$175

Appendix Figure 5

Housing and Homelessness: Discretionary Spending Proposals in the 2021-22 Governor's Budget (In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
Medi-Cal	Provide grants to counties for behavioral health infrastructure	—	\$750	—
HCD	Funding to continue Homekey program	\$250	500	—
HCD	Funding for housing-related infrastructure	250	250	—
HCD	Assistance for housing law compliance	—	—	\$4
RCFE and ARF	Expand RCFE and ARF housing for seniors at risk of homelessness	—	250	—
Totals		\$500	\$1,750	\$4

HCD = California Department of Housing and Community Development RCFE = Residential Care Facilities for the Elderly; and ARF = Adult Residential Facilities

Appendix Figure 6

Human Services: Discretionary Spending Proposals in the 2021-22 Governor's Budget (In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
Child Care	COVID-19 related support to providers and families	—	\$55.0	—
Child Welfare	Expansions and flexibilities for non-minor dependents and former foster youth	—	49.5	—
CalWORKs	Prevent adults from timing out of cash aid during pandemic	—	46.1	—
Food banks	Augment funding for food banks during pandemic	—	30.0	—
SNB and TNB	Increase benefit amounts in SNB and TNB programs	—	—	\$23.1
CalWORKs	Reinstate funding for Cal-OAR accountability project	—	—	19.6
IHSS	Adjust IHSS county administration for caseload increases	—	—	17.8
CFAP	Augment CFAP benefits consistent with federal CalFresh actions	—	11.4	—
DDS	Various proposals	—	3.4	7.8
Child Welfare	Various proposals	—	11.2	5.9
Child Support	Various proposals	—	—	16.6
Other	Various proposals	—	17.8	—
Totals		—	\$224.4	\$90.7

COVID-19 = coronavirus disease 2019; SNB = Supplemental Nutrition Benefit program; TNB = Transitional Nutrition Benefit program; Cal-OAR = CalWORKs Outcomes and Accountability Review; IHSS = In-Home Supportive Services; CFAP = California Food Access Program; and DDS = Department of Developmental Services.

Appendix Figure 7

Resources and Environmental: Discretionary Spending Proposals in the 2021-22 Governor's Budget
(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
Climate Catalyst Fund	Sustainable agriculture funding	\$50.0	—	—
Climate Catalyst Fund	Forest resilience funding	47.0	—	—
Conservation Corps	Wildfire and forest resilience package	—	\$15.0	—
Conservation Corps	Additional fire crews	—	—	\$5.9
Department of Conservation	Wildfire and forest resilience package	25.0	60.0	—
Department of Fish and Wildlife	Wildfire and forest resilience package	9.0	36.0	—
Department of Fish and Wildlife	Various one-time upgrades and equipment	—	41.8	—
CalFire	Wildfire and forest resilience package	61.1	195.0	—
CalFire	Additional fire crews	—	—	137.3
CalFire	Various capital outlay projects	—	54.2	—
CalFire	Deferred maintenance	—	10.0	—
CalFire	Other proposals	—	5.0	8.3
Department of Parks and Recreation	Wildland firefighting research grant	10.0	75.0	—
Department of Parks and Recreation	Deferred maintenance	—	20.0	—
Department of Parks and Recreation	Backfill for Harbors and Watercraft Fund	—	10.0	—
Department of Parks and Recreation	Woolsey wildfire repairs	—	10.0	—
Department of Parks and Recreation	Other proposals	—	15.2	—
Department of Pesticide Regulation	Integrated pest management programs	—	8.3	—
DTSC	Exide facility closure	20.0	66.0	—
DTSC	Cleanup of contaminated properties in impacted communities	—	300.0	—
DTSC	Backfill for Hazardous Waste Control Account	—	22.5	—
DTSC	Legal cost recovery for Exide facility	—	14.0	—
DTSC	Backfill for Toxic Substances Control Account	—	13.0	—
Department of Water Resources	Sustainable groundwater management grants	30.0	30.0	—
Department of Water Resources	Deferred maintenance of levees	—	75.0	—
Department of Water Resources	American River flood project	—	67.0	—
DGS	Resources Building renovation	—	452.1	—
Natural Resources Agency	Wildfire and forest resilience package	—	15.0	—
Sierra Nevada Conservancy	Wildfire and forest resilience package	20.0	50.0	—
State Lands Commission	Wildfire and forest resilience package	—	12.0	—
Tahoe Conservancy	Wildfire and forest resilience package	1.0	11.0	—
Totals		\$273.0	\$1,683.0	\$152.0

CalFire = California Department of Forestry and Fire Protection; DTSC = Department of Toxic Substances Control; and DGS = Department of General Services.

Appendix Figure 8

Other: Discretionary Spending Proposals in the 2021-22 Governor's Budget

(In Millions)

Program or Department	Proposal	2020-21	2021-22	
			One Time or Temporary	Ongoing
ABC	License Renewal Fee Waiver	\$45.0	—	—
Arts Council	California Creative Corps Pilot Program	5.0	\$10.0	—
Board of Barbering and Cosmetology	License Renewal Fee Waiver	25.6	—	—
California State Library	Various proposals	—	8.0	—
CalSTRS	External investment audit services	—	—	\$12.3
Department of Food and Agriculture	State Water Efficiency and Enhancement Program grants	20.0	20.0	—
Department of Food and Agriculture	Support for state-affiliated fairgrounds	—	50.0	—
Department of Food and Agriculture	Blythe and Needles Border Protection Stations	—	14.4	—
Department of Food and Agriculture	Integrated pest management programs	—	11.8	—
Department of Food and Agriculture	Deferred maintenance at fairgrounds	—	10.0	—
Department of Food and Agriculture	Farm to School grant program	—	10.0	—
Department of Technology	Fund information security audit program and Security Operation Center with General Fund	—	—	21.0
Department of Technology	Stabilize IT systems and staff Broadband for All efforts	—	—	11.4
DGS	Gregory Bateson Building Renovation	—	191.6	—
DGS	Jesse Unruh Building Renovation	—	122.4	—
DGS	OS EVSE Infrastructure Assessment and Facility Development	—	50.0	—
DGS	One-time deferred maintenance allocation	—	20.0	—
Franchise Tax Board	Second phase of Enterprise, Data, Revenue project	—	—	55.6
Department of Insurance	Enhance insurance fraud investigation and prevention	—	—	6.1
GovOps, Secretary	Develop and implement Cradle-to-Career Data System	—	3.0	12.0
GovOps, Secretary	Implement statewide data strategy	—	—	0.6
GO-Biz	Cultural institutions grants	25.0	—	—
CWDB	Expand existing apprenticeships	25.0	—	—
OES	Home Hardening and Community Protection	21.9	—	—
OES	California Disaster Assistance Act adjustment	—	193.5	—
OES	California Earthquake Early Warning System	—	17.3	—
OES	One-time deferred maintenance allocation	—	5.0	—
School Facilities	Construction and renovation of TK and full-day Kindergarten facilities	—	200.0	—
Totals		\$167.5	\$936.8	\$120.8

ABC = Department of Alcoholic Beverage Control; IT = information technology; DGS = Department of General Services; OS = Office of Sustainability; EVSE = Electric Vehicle Supply Equipment; GovOps = California Government Operations Agency; GO-Biz = Governor's Office of Business and Economic Development; CWDB = California Workforce Development Board; OES = Governor's Office of Emergency Services; and TK = Transitional Kindergarten.

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