Sequestering Savings From the Closure of Developmental Centers

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LAO

Cover Photo: The cover photo of the Sonoma Developmental Center was provided courtesy of the California Department of Developmental Services.

Executive Summary

The *Supplemental Report of the 2017-18 Budget Act* requires the Legislative Analyst's Office to analyze a proposal about sequestering potential savings from the closure of Developmental Centers (DCs) and keeping the savings in the Department of Developmental Services (DDS) community services system. This report addresses that requirement. In this report, we discuss the two main potential sources of savings—(1) net operational savings and (2) increased revenues from the sale or leasing of DC properties.

Background

State Closing Most of the Remaining DCs. DDS is in the process of closing three DCs—Sonoma DC by the end of 2018 and Fairview DC and the general treatment area at Porterville DC by the end of 2021 (what we are calling closure DCs). From 2017-18 through final closures, DDS will transition 534 remaining DC residents to the community. While DDS will continue to run Canyon Springs Community Facility and a secured treatment program at Porterville DC, the imminent closures mean that nearly all DDS consumers—more than 315,000 individuals with developmental disabilities—will be served in community-based settings.

DC Closures Have Led to Community Development Costs. The state has incurred significant costs over time (in the low hundreds of millions of dollars) to develop new housing and other community-based programs to accommodate the special needs of individuals transitioning from DCs into the community. It has also incurred costs (about $20 million) to develop community-based crisis and safety net services. DCs have traditionally served as the "safety net" for DDS consumers in crisis. Once closed, DCs will no longer fill this role.

Net Operational Savings From DC Closures

DC costs are very expensive, largely due to the substantial fixed costs of running and maintaining the facilities. While the state will reduce its costs notably by closing DCs, it will incur significant new costs to provide services to former DC residents in the community.

Net Operational Savings Could Reach $100 Million Annually. As shown in the figure, we estimate that once DC closure activity is complete the state will save about $100 million annually (in today's dollars). The components of the calculation are:

- ***General Fund Avoided Costs at DCs.*** The 2017-18 General Fund costs at closure DCs total about $200 million. This is the amount the state will avoid spending once DCs are fully closed.
- ***New Ongoing Annual Costs in the Community.*** Once closures are complete, we estimate the state

Estimated Annual Net Operational Savings After DC Closures

General Fund (In Millions of 2017-18 Dollars)

Reduced spending at closure DCs	$200
Less:	
DDS cost of community services for former DC residents	-60
DDS cost to operate/provide safety net and crisis services	-25
Costs in other state departments[a]	-15
Total Estimated Annual Net Operational Savings	**$100**

[a] Costs include the state portion of Medi-Cal, Supplemental Security Income/State Supplemental Payment, and In-Home Supportive Services payments.

DCs = Developmental Centers and DDS = Department of Developmental Services.

will incur annual General Fund costs of about $75 million to serve the 534 DC residents moving to the community. We estimate the state will also spend about $25 million General Fund annually to provide community-based safety net services.

This amount could vary significantly depending on the specific needs of the former DC residents once transitioned to the community. It is also important to note this amount does not include the significant one-time costs to develop community-based safety net services and housing and programs for consumers moving from DCs in the intervening years between 2017-18 and the completion of closures.

Potential Revenues From DC Closure Properties

The other potential source of savings that could result from DC closures is the sale or repurposing (specifically leasing) of DC closure properties.

Selling DC Properties. The Legislature could decide to sell individual parcels or entire DC properties to generate revenue for DDS. To do so, it would likely have to bypass the typical process for disposing of surplus state properties. Selling properties would reduce the state's liability at these locations and generate an influx of revenue, but the valuation and sale potential of each DC depend on its unique characteristics—such as location, infrastructure, and local zoning rules. Aging infrastructure at Sonoma DC, for example, would adversely affect its valuation and sale potential.

Leasing DC Properties. The Legislature could instead allow DDS to lease portions of the DC properties to private entities to generate an ongoing source of revenue for DDS. There is precedent for DDS leasing property for the development of mixed-income housing—Harbor Village, on Fairview DC grounds, includes more than 550 housing units, of which 31 percent are occupied by DDS consumers. A second housing development is also in the planning phase at Fairview DC. Using leases in this way increases available affordable housing—which could be a legislative policy objective. However, if the terms of the Harbor Village agreement serve as a guide, it could take many years before such an arrangement generates revenue for DDS. In addition, the location of each DC, coupled with local zoning rules and preferences, could affect the viability of this option. For example, the location of Sonoma DC may not be ideal for housing DDS consumers because it is not in close proximity to other community-based services.

LAO Bottom Line. Each of the closure DCs has unique characteristics that will affect the state's ability to generate revenues from the sale or leasing of properties. Sonoma DC and Fairview DC present the most fertile opportunities, but developing on these properties would require close collaboration with local governments. Developing mixed-income housing through a state lease would also require careful consideration of how DDS consumers would be integrated into the community.

Other Practical Implications for Legislative Consideration

Does the Current Legislature Want to Tie the Hands of Future Legislatures? While earmarking savings from DC closures could provide a potential source of dedicated funding for DDS, doing so constrains the ability of future Legislatures to make budgetary decisions. Regardless of its action on the proposal reviewed in this report, the Legislature always has the choice to increase funding for DDS.

How Would the Legislature Effectively Target Savings to the DDS System? Should the Legislature decide to target savings for the DDS system, it would likely want to deposit the savings into a special fund and decide how the fund could be used. It would be fiscally prudent to ensure any ongoing spending commitments align with ongoing sources of funding. In addition, the Legislature would benefit from requiring a comprehensive assessment of service gaps and related unmet funding requirements in the community services program. This would help guide the use of any additional resources provided for the program.

INTRODUCTION

The *Supplemental Report of the 2017-18 Budget Act* called for the Legislative Analyst's Office (LAO) to examine a proposal by Assembly Member Devon Mathis about sequestering savings from the closure of Developmental Centers (DCs) for Regional Center (RC) community services. It directed our office to conduct an analysis of the possible savings that could result from the scheduled closure of DCs; ways to keep these savings in the Department of Developmental Services (DDS) system for the benefit of DDS consumers; and the policy, fiscal, and practical implications of the various options to implement the proposal as well as the proposal overall. This report addresses those requirements.

In this report, we (1) provide brief background information about DC closures and the DDS budget, (2) discuss potential savings in terms of net operational savings and increased revenues from the sale or repurposing (specifically leasing) of DC properties, and (3) address other practical implications and trade-offs of the proposal.

BACKGROUND

Deinstitutionalization Is a National Trend

Deinstitutionalization is a national trend for people with developmental disabilities, particularly after the U.S. Supreme Court's 1999 *Olmstead v. L.C.* decision provided that under the Americans with Disabilities Act of 1990, states must place individuals with mental disabilities in the least restrictive integrated community-based settings possible (taking into account available state resources). According to the American Association on Intellectual and Developmental Disabilities, the number of residents with developmental disabilities living in public institutions nationwide declined from about 85,000 in 1990 to about 25,000 in 2013. Over the same period in California, the number of DDS consumers living in DCs declined from about 6,700 to about 1,500.

The Federal Government Facilitates Provision of Community-Based Services. The federal Centers for Medicare and Medicaid Services (CMS) have greatly expanded states' ability to receive funding for home- and community-based services through Medicaid Waiver programs. In 2017-18, DDS expects to receive nearly $2 billion through these programs, which are intended to provide community-based services as an alternative to institutionalization. CMS only provides waiver funding to states if the cost of waiver services provided in the community does not exceed the cost of services provided in an institutional setting.

Overview of DC Closures

State to Close Most of the Remaining DCs by the End of 2021. DDS currently operates three DCs and one community facility for individuals with developmental disabilities. (DDS has operated up to seven DCs and two community facilities in the past. Between 1996 and 2015, it closed four of the DCs and one of the community facilities.) Porterville DC includes both a general treatment area as well as a secured treatment program, which serves individuals under a court order because they are a safety risk to themselves or others and/or have been deemed incompetent to stand trial. In 2015, the Governor announced plans to fully close two DCs—Sonoma and Fairview—and partially close a third—the general treatment area at Porterville DC. The Legislature enacted Chapter 23 of 2015 (SB 82, Committee of Budget and Fiscal Review) requiring DDS to submit closure plans for DCs that would close. Figure 1 (see next page) shows the locations, closure dates (if applicable), and number of residents at each state-run institution.

Transition of DC Residents to the Community Involves a Comprehensive Assessment. Since 2012, statute requires RCs—the independent nonprofit agencies that coordinate services for DDS consumers living in the community—to conduct a comprehensive assessment of each DC resident who will be moving into the community. The assessment, which includes input from RCs, the consumer, and the consumer's

Figure 1

State to Fully or Partially Close Three Developmental Centers (DCs)

State-Run Institution	County	Closing?	Sheduled Closure Date	Number of Residents (as of July 1, 2017)
Sonoma DC	Sonoma	Yes	December 2018	256
Fairview DC	Orange	Yes	December 2021	162
Porterville DC—General treatment area	Tulare	Yes	December 2021	116
Porterville DC—Secured treatment program	Tulare	No	—	205[a]
Canyon Springs Community Facility	Riverside	No	—	48[b]

[a] Statute currently limits the population at Porterville DC's secure treatment program to 211.
[b] Canyon Springs Community Facility can serve up to 63 residents at one time.

family (if applicable), identifies the services and supports the consumer needs to live in the community. It also indicates which of these services and supports are currently available and which would need to be developed. The RCs use this information to prepare and submit proposals to DDS for the development of new or expanded community-based services and supports, such as community living options or health care services.

Community Placement Plan Guides Development of New Services. DDS develops an annual community placement plan (CPP) that responds to the needs of DC residents transitioning into the community. DDS uses CPP funds for the following four purposes:

- Start-up: Development of new housing and other community-based programs.
- Assessment: Comprehensive planning of an individual's needs as discussed above.
- Placement: An individual's community service costs in the first months after transitioning from the DC.
- Deflection: Community service costs of individuals who would have otherwise been placed in a DC in the past.

The annual CPP responds to many of the RC proposals for the development of new or expanded services and supports. The state budget currently allocates about $55 million of base funding annually for the CPP, which has been augmented in recent years on a one-time basis. For example, it was augmented by $73 million General Fund in 2016-17 and by $22 million General Fund in 2017-18.

DDS Must Develop a Community-Based "Safety Net" as a Result of Closures. Sonoma DC and Fairview DC each currently house an acute crisis center, which can serve up to five people at any given time. DDS makes these centers available to anyone in the DDS system who is in crisis and needs temporary treatment (for up to 12 months). The ten slots are nearly always full. Once DDS fully closes these two DCs, the acute crisis centers will no longer be available to the system at large. As required by statute, DDS presented a plan for crisis and safety net services in May 2017. In addition to identifying needed funding to help develop numerous vendor-operated homes and services, the plan calls for the development of five state-run acute crisis homes (three in Northern California and two in Southern California), two state-run mobile crisis teams, and state-operated intensive wrap-around services for people with mental health diagnoses in addition to their developmental disabilities. The 2017-18 state budget appropriated $21.2 million (mostly General Fund, including CPP funding) for the development of these homes and services.

Overview of DDS Budget

The service delivery model at DCs differs significantly from the service delivery model in DDS's community services program. Whereas DCs are more akin to a "one-stop shop" with all services and care delivered on-site by state employees, community services are delivered more "a la carte" with RCs coordinating and paying for individual services from a variety of independent providers. In this section, we describe each model and how DDS budgets for them and provide an overview of current expenditures and funding sources.

DC Budget Includes Costs to Provide Services On-Site and Operate and Maintain Facilities. DCs, which are run by state employees, provide all the services and supports residents require on-site, such as medical, dental, pharmaceutical, therapeutic, and day program services. State employees also prepare and serve meals, provide employment opportunities for residents, and maintain the grounds and facilities. The service and support needs of residents are determined through an individual planning process, which includes participation by the resident, his or her family (if applicable), relevant DC and/or RC staff, and others. DCs are licensed as acute care hospitals and include skilled nursing units, intermediate care facility/developmentally disabled units, and acute crisis units (at Sonoma and Fairview DCs). DDS prepares a budget for DCs, which is based on resident population (and when certain residents are scheduled to transition to the community), the level of care and staffing needed for each type of unit, and other overhead and operating costs.

Community Services Budget Includes RC Administrative Operations Costs and the Cost to Purchase Services for Consumers. In the community services program, a consumer's services and support needs are also determined through an individual planning process by an interdisciplinary team that includes the consumer, his or her family (if applicable), the RC service coordinator, and any other relevant RC or service provider staff. RCs coordinate the individual services and supports—such as residential, medical, day program, respite, employment, and transportation services—for consumers. Nearly 45,000 independent service providers provide the services and receive payment from RCs. Before RCs can pay for these individual services from their purchase-of-service (POS) budget, statute requires them to first access services available through other state programs, such as Medi-Cal, or from private third-party payors, such as private health insurance plans. DDS prepares a budget for the community services program that is based on estimated population, POS costs, and RCs' operating costs (which include the salaries of service coordinators). When a DC resident transitions to the community, he or she will have had a comprehensive assessment to determine what he or she will need in the community. DDS's community services program budget reflects the cost to provide these identified services to the individual.

State Currently Spends Nearly $360 Million General Fund on DCs. DDS's 2017-18 budget for all DCs and Canyon Springs Community Facility (Canyon Springs) totals about $490 million (all funds). The state's General Fund provides $360 million or three-quarters of DC funding, while federal Medicaid reimbursements cover the rest. (Medicaid funds these long-term institutional services and supports, including both medical and nonmedical care, for eligible individuals with developmental disabilities. To receive funding, state-run facilities must comply with federal regulations. Sonoma DC's intermediate care facilities/developmentally disabled units for example, no longer receive federal funding after failing certification surveys. Because of its more correctional-like setting, the secure treatment program at Porterville DC is ineligible for federal funding.) The total DC population at the start of the fiscal year on July 1, 2017 was 795 and will decline to an estimated 537 at the end of the fiscal year on June 30, 2018 as DC residents continue to transition to the community.

General Fund Currently Provides About $3.8 Billion for Community Services. DDS's 2017-18 budget for the community services program totals $6.4 billion (all funds) to serve nearly 318,000 individuals. The General Fund provides $3.8 billion, while federal funding accounts for nearly all the rest—primarily Medicaid Waiver and Title XX social services funding. (Medicaid Waiver programs fund a variety of community-based services and supports that are not otherwise covered by Medicaid for individuals who require long-term services and supports and would otherwise be institutionalized.) Notably, the DDS community services program budget includes the cost to transition and place DC residents in the community and provides for their ongoing community-based services.

NET OPERATIONAL SAVINGS

DC costs are very expensive, in large part due to the substantial fixed costs of running and maintaining the facilities. In 2017-18, the state will employ more than 3,800 people to serve DC residents and run and maintain the facilities—roughly five to six employees per DC resident. The state will reduce its costs notably as Sonoma DC, Fairview DC, and the general treatment area of Porterville DC are closed down over the coming few years. At the same time, these reduced costs will be offset to some degree by the cost to provide services to former DC residents in the community. The net savings in the intervening years between now and the completion of closure activity can be difficult to assess because of timing issues related to the phasing out of DC costs while community-based costs are being phased in. (The nearby box notes how timing explains the greatly varying average per-person cost at DCs over the next few years as closure activity reaches its completion.) To simplify an otherwise complex calculation, we assess current DC costs and the amount by which these costs will be reduced after the final closures against the ongoing annual costs in the community as a result of these closures. We make this calculation in 2017-18 dollars.

Calculating Net Operational Savings

Assembly Member Mathis's proposal notes the significant average annual per-person cost to serve someone at a DC—roughly $735,000 from all fund sources in 2017-18. By comparison, his proposal mentions a 2015-16 analysis by our office that pegged the average annual state cost (including DDS costs and costs in other programs) to serve consumers who had formerly resided at Lanterman DC (which closed in 2014) in the community at $75,000 to $300,000 (from all fund sources) depending on residence type.

Need to Focus on General Fund Impact of Closing Specific DCs. The amount noted above for average per-person DC cost includes federal funding as well as the costs to run Canyon Springs and the secure treatment program at Porterville DC, both of which will remain open. The only potential source of net operational state savings, however, results from *General Fund* costs avoided (rather than *total* costs avoided) at what we are calling *closure DCs*—Sonoma DC, Fairview DC, and the general treatment area at Porterville DC (rather than at all DCs and Canyon Springs together). In this regard, DDS will spend about $200 million from the General Fund in 2017-18 at closure DCs (about $500,000 per person)—a rough estimate of the total amount of General Fund costs that will be avoided once the closures are completed.

State Will Incur New Community-Based Costs as a Result of DC Closures. About 534 DC residents will transition from DCs to the community from 2017-18 through final closures. To serve these

Continually Changing and Increasing Per-Person Costs at DCs

Annual per-person Developmental Center (DC) costs have been increasing substantially in recent years as fixed costs at the DCs (which remain regardless of the number of residents) are spread over fewer and fewer residents. Because residents are regularly transitioning to the community from DCs, the average per-person cost will vary significantly from one point in time to another, even within the same fiscal year. For example, the average per-person cost will be higher at the end of 2017-18 than at the beginning of 2017-18 because the Department of Developmental Services will be moving 274 residents to the community over the course of the year. In addition, the per-person DC cost one year does not equate to the amount by which spending would decline the following year for each person who moves. For example, to say it costs $500,000 General Fund per person at Fairview DC in 2017-18 does not mean the state will reduce its Fairview DC expenditures by $500,000 in 2018-19 for each person who moved to the community in 2017-18. Because of fixed costs, a good portion of that amount will not be realized as savings until after Fairview DC closes.

individuals in the community after final closures, we estimate annual General Fund costs of about $75 million (in today's dollars). This includes $60 million in General Fund costs to DDS for provision of community services and RC service coordination, which we based on the average 2016-17 General Fund cost to DDS to serve people who moved from DCs in 2013-14 through 2015-16. It also includes $15 million in General Fund costs to other state departments for the state share of programs such as Medi-Cal, Supplemental Security Income/State Supplementary Payment (SSI/SSP), and In-Home Supportive Services.

In addition, as discussed earlier, the state will fund vendor-run and state-run community-based safety net and crisis services due to DC closures. DDS will operate at least five homes and two mobile crisis units and provide intensive wrap-around services for DDS consumers with mental health diagnoses. It will also pay for services provided at six new vendor-run homes and wrap-around services for consumers transitioning from the secure treatment program at Porterville DC. We estimate that these safety net and crisis services will cost about $25 million General Fund annually by the time DCs are fully closed.

LAO Bottom Line: Net Operational Savings Could Reach $100 Million Annually, but Vary Significantly From This Amount. As detailed in Figure 2, we estimate that the most the state will save, on net, in annual General Fund spending following DC closures is $100 million in today's dollars. This amount could vary significantly for several important reasons:

- We do not include in this net savings amount a dollar figure to account for the significant one-time costs to develop community-based homes and programs for consumers moving from DCs. For example, the state spent approximately $75 million in 2015-16 and $90 million in 2016-17, and will have spent about $25 million in 2017-18, on such "start-up" costs from DDS's CPP. While we chose not to include these one-time amounts in our estimate (since these costs would be properly allocated over several years as they provide benefits over time), they would serve to reduce the amount of net operational savings if included. Similarly, we did not include the cost to develop safety net resources (about $20 million).
- The annual DDS cost to serve the remaining DC residents in the community after final DC closures will likely be more than the cost to serve individuals who moved in earlier years (which was the basis for the $60 million amount). The remaining DC residents tend to be somewhat more medically fragile and have more complex service needs on average than consumers who moved in earlier years.
- The total General Fund cost to provide safety net and crisis services after development is uncertain. The $25 million amount in Figure 2 is extrapolated from current estimates by DDS to operate four homes and a mobile crisis team in 2018-19.
- The costs in other state programs as a result of DC closures is highly uncertain.

Although the cost estimates for serving individuals in the community are uncertain, we expect the state to realize at least some net operational savings (as we have defined it). For example, even if each of the costs listed in Figure 2 were twice what we estimated, the state would still break even as a result of DC closure activity since 2017-18.

Figure 2

Estimated Annual Net Operational Savings After DC Closures

General Fund (In Millions of 2017-18 Dollars)

Reduced spending at closure DCs	$200
Less:	
DDS cost of community services for former DC residents	-60
DDS cost to operate/provide safety net and crisis services	-25
Costs in other state departments[a]	-15
Total Estimated Annual Net Operational Savings	**$100**

[a] Costs include the state portion of Medi-Cal, Supplemental Security Income/State Supplemental Payment, and In-Home Supportive Services payments.

DCs = Developmental Centers and DDS = Department of Developmental Services.

POTENTIAL REVENUES FROM DC CLOSURE PROPERTIES

When the state must decide what to do with a state-owned property that is no longer required for its existing purposes, it is important to consider its goals first. Is the goal to generate revenue? Provide affordable housing? Create open space or parks? Meet the land and facilities needs of another state department? Between 1996 and 2015, DDS closed four DCs (including two campuses at Agnews DC), and in three cases, the land was transferred to California State University to expand its campuses or add a new campus. Figure 3 provides more detail about these recent closures.

Assembly Member Mathis's proposal suggests that one goal regarding what to do with the closure DC properties should be generating revenue to benefit the DDS Community Services Program. If the goal is indeed to generate revenue from the sale or leasing of remaining DC properties, there are several ways to do this, which we discuss below. We also highlight some of the key benefits and challenges associated with each option.

SELLING DC PROPERTIES

The Legislature could decide to sell individual parcels or entire DC properties as a way to generate revenue for DDS.

Potential Benefits of This Option

For one, the state would no longer be responsible for the properties, which means it would have reduced liability for the property and would not have to maintain it. Two, the one-time influx of revenue could be set aside and earn interest, which could serve as an ongoing source of revenue for investments in the DDS system. Three, the principal could provide a one-time source of revenue for special projects or priorities.

Potential Challenges and Issues Raised by This Option

Numerous issues arise in trying to sell the DC properties to generate revenue for DDS activities.

The Unique Characteristics of Each Property Affect Market Value and Sale Potential. Each DC site has unique characteristics in terms of location, age of facilities, infrastructure, historical value, local interest, and size. These unique characteristics will affect the market value of each (making it unlikely to find comparable properties to easily determine their market value). Some of these characteristics may complicate the sale potential of the property. These unique characteristics of each closure include:

Figure 3

What Happened to DC Properties After Other Completed Closures?

DC	Location	Acreage	Year Closed	Sold, Leased, or Transferred to Another State Entity?	Revenues
Stockton DC	Stockton, San Joaquin County	100 acres	1996	Transferred to California State University (CSU) Stanislaus, Stockton Center	N/A
Camarillo State Hospital and DC	Camarillo, Ventura County	1,500 acres	1997	Transferred to CSU Channel Islands	N/A
Agnews DC — West Campus	San Jose, Santa Clara County	324 acres	2009	Sold mainly to private entities. One parcel leased.	$250 million
Agnews DC — East Campus	San Jose, Santa Clara County	424 acres	2009	Sold to a combination of private entities and local government.	$120 million
Lanterman DC	Pomona, Los Angeles County	300 acres	2014	Transferred to CSU Cal Poly Pomona	N/A

DC = Developmental Center.

- ***Sonoma DC.*** Sonoma DC, which opened in 1891, is located on 900 largely undeveloped acres in the heart of California's wine country, making it a potentially appealing property for a vineyard, hotels, other tourism-related businesses, or a housing developer. However, local preferences required local voter approval, and zoning rules may restrict extensive commercial and housing development by a private entity, especially since there is known local interest in preserving a vast amount of open space and protecting wildlife habitat. In addition, alternative uses of the existing, aging infrastructure on the site would be costly.
- ***Fairview DC.*** Fairview DC, which opened in 1959, is located on 114 acres in the City of Costa Mesa in Orange County. It is surrounded on three sides by a golf course. The golf course sits on land that was formerly part of Fairview DC but sold to the City of Costa Mesa. The Fairview DC property currently includes a 564-unit mixed-income housing complex called Harbor Village. Another 20 acres has been set aside for a second mixed-income housing development (both housing developments are discussed later in this report). Although Fairview DC's urban location in Costa Mesa make it ideal for development, the City of Costa Mesa has already passed zoning rules that would limit development. In addition, voters passed Measure Y in 2016, which requires voter approval for certain development projects.
- ***Porterville DC.*** Porterville DC, which opened in 1953, sits on 670 acres in the town of Porterville in Tulare County. Porterville DC is somewhat more remote than the other DCs, with the closest airport in Visalia, 40 miles away. Six groundwater wells supply Porterville DC's water and the site includes its own water treatment plant. It may be challenging to sell the property of the general treatment area to a private entity. First, the relatively remote location may decrease demand. Second, the general treatment area is located next to the secure treatment program, which is a locked facility for individuals who have been deemed a safety risk and/or incompetent to stand trial. Demand to develop next to a locked facility is likely low. (A more conceivable potential buyer might be in a prison- or health-related field.) Third, the general treatment area and the secure treatment program share utility infrastructure and support facilities, which the state will need to retain to continue serving the secure treatment program. In recent years, for example, the state has invested close to $8 million for roof repairs, fire alarm upgrades, and a nitrate removal system for the water supply (this project is currently underway).

Current Value of DC Properties Is Unknown. It is unknown what each of the three closure properties—including both land and buildings—are currently worth. While all three sites underwent a 1996 conditions assessment by a private company and a 2012 infrastructure assessment by the Department of General Services (DGS), these assessments shed limited light on current valuation. Much of the focus was on the types of infrastructure improvements, such as seismic retrofit, that were needed to protect the health and safety of residents. At Sonoma DC, DGS is currently in the process of working with a private company to complete an updated conditions assessment of the property, which will likely be released in February or March of this year. This assessment will inform a valuation of the property and understanding of its sale potential. Because Fairview DC and the general treatment area at Porterville DC are set to close later than Sonoma DC, some of the activities that will inform valuation have not yet begun.

We have chosen not to speculate on the value of each DC closure property as it is highly dependent on a variety of factors, including local zoning rules and preferences, the cost to repair infrastructure, location, and valuation-related information that is not fully known at this point.

Legislative Authority May Be Needed to Bypass Typical Surplus Property Process. The box on the next page describes the typical process for disposing of surplus state properties. What triggers the typical process is the property being declared excess by the state department using it. DDS has indicated that it will not declare the Sonoma DC property excess and has assured local government and stakeholder groups that it will solicit input on the disposition of the property. Regarding Fairview DC, DGS and DDS are currently working together to determine whether DDS has future programmatic needs there and what the timeline might be for declaring the property excess. Regarding Porterville DC, DGS and DDS are still in the process of determining whether any parcels at Porterville DC could be declared excess in light of the ongoing operation of the secure treatment program.

If the Legislature decides it wants to sell the DC properties as a way to generate revenue for the benefit of DDS, it may have to authorize bypassing the typical surplus property process, for two main reasons. First, when a property is going to be sold, the typical process provides that it first be offered to local government and then to affordable housing developers. If neither expresses interest, the surplus state property can be sold at fair market value to private entities. Second, according to the State Constitution, any revenue generated from the sale of surplus state property is to be deposited into the Special Fund for Economic Uncertainties, the state's discretionary budget reserve. There is precedent for the Legislature bypassing the surplus property process. For example, Chapter 510 of 2016 (AB 1900, Jones-Sawyer) deemed the San Pedro Superior Courthouse not to be surplus and authorized the Judicial Council to sell it and deposit the proceeds into a special court facilities construction fund.

Local Governments' Preferences Could Affect Sales. DC properties are subject to local zoning rules if sold or leased to a private entity, which could affect the value of the property and the interest of private entities in purchasing the properties. For example, the City of Costa Mesa has zoned a portion of Fairview DC property as open space and other portions for single-family residential development, public facilities, or recreational uses. (If the land is not sold, but instead transferred to another state department, it would not

Typical Process for Disposing of Surplus State Properties

When a state department determines that it no longer needs a state-owned property for its current or future programmatic purposes, it triggers a process for disposing the property, as follows:

- ✓ The state department notifies the Department of General Services (DGS) that it no longer needs the property in question. The property is declared excess.
- ✓ DGS directs the state department to work with the Office of Historic Preservation to assess the historic value of properties that are at least 50 years old.
- ✓ DGS notifies state departments of the excess property. Departments have 60 days to express preliminary interest. DGS also works with its Real Estate Services Division to proactively identify any departments with current or future need for land or facilities in the area of the excess property.
- ✓ With approval of the Department of Finance, the excess property is transferred to a selected state department.
- ✓ If no state department expresses interest in the excess property, it is added to DGS's annual list of surplus properties, which is submitted to the Legislature for approval.
- ✓ Upon approval, DGS can sell the land in the following order, according to statute:
  - It is first offered to local agencies.
  - It is then offered to nonprofit affordable housing developers.
  - It is then offered to private entities or individuals at fair market value.
- ✓ Section 9 of Article 3 of the California Constitution requires that proceeds from the sale of surplus state properties be deposited into the Special Fund for Economic Uncertainties, the state's discretionary budget reserve.

be subject to local zoning rules.) If the Legislature decides its primary goal is to generate revenues from the sale of the properties, it may need to work with local governments to maximize sale potential. This could include for example, rezoning parcels for commercial or residential development.

LEASING DC PROPERTIES

DDS could work with DGS to lease portions of the DC properties to a private entity. It is not common to do so. The primary reason the state does occasionally do this is to keep the property available for potential future use by the state. As required by statute, lease proceeds are typically deposited into the General Fund. If the state leases the property to a private developer, the property is subject to local zoning rules.

Potential Benefits of This Option

Leasing parcels of DC properties to private entities would generate an ongoing source of revenue for DDS if the Legislature stipulated that DDS could keep the proceeds. Retaining the properties also means they could be available for potential future use by the state. Finally, as discussed in detail below, there is precedent for using this option as a means to increase the supply of mixed-income housing for DDS consumers and other area residents.

Potential Challenges and Issues Raised by This Option

As noted earlier, each DC closure property comes with its unique characteristics, some of which would not necessarily be conducive to leasing or attractive to potential lessees, such as location or aging infrastructure. In addition, we note that the state rarely serves as lessor of properties. The state is not in the business of being a landlord and it typically tries to avoid the liability and other risks associated with leasing out properties. While the state sometimes negotiates a lease to increase the supply of affordable housing, it is not typical to lease the properties to a private entity primarily to generate revenues. The state may also have an interest in selling the land rather than leasing it as a way for both state and local governments to begin generating property tax revenue and creating jobs.

Leasing DC Property to a Housing Developer

In this section, we discuss one specific leasing option—providing a long-term ground lease to a developer of mixed-income housing. We focus on this option since, as noted in the box on page 12, there is precedent for this type of project within the DDS system—Harbor Village and Shannon's Mountain, both located on Fairview DC property. We note that while revenue generation is a benefit of this option, it would unlikely be the primary driver. This option mainly serves other public policy objectives—namely the provision of affordable housing to specified beneficiaries. Below, we discuss the potential benefits and challenges of long-term ground leases for housing developments.

Potential Benefits. One benefit of this option, given California's well-documented housing shortage, is that it provides housing to DDS consumers and other members of the community (low-income and otherwise). Like Harbor Village and Shannon's Mountain, the Legislature could authorize DDS to use surplus rental proceeds to subsidize the rental payments of DDS consumers (and any needed refurbishments to accommodate their special needs). DDS consumers who live in their own apartments typically pay rent with SSI/SSP. It is often difficult to find affordable apartments in high-cost areas of the state, such as the Bay Area and Orange County (where Sonoma DC and Fairview DC, respectively, are each located). While the primary goal of this option is not to generate revenue, but to provide housing, rental proceeds could ultimately generate revenues for the benefit of the DDS system.

Potential Challenges and Issues. There are several challenges and issues associated with this option that should be considered. Fairview DC property would be a good location for another housing development because it is close to other services, such as day programs and health care services. However, Fairview DC already has one housing development (Harbor Village) and another underway (Shannon's Mountain). It may be difficult to develop a third because of local zoning rules and required voter approval, although the state could attempt to work with the City of Costa Mesa to sort through these issues. Another consideration with developing additional mixed-income housing at Fairview DC is the notion of community integration, which is one goal of deinstitutionalization. Integration of individuals with developmental disabilities into the community at-large is also a requirement to receive federal funding through Home- and Community-Based Medicaid Waiver funding. If hundreds of DDS consumers are concentrated on Fairview DC property, it raises the question of whether this could be viewed as contrary to required community integration. There may be ways to ensure that DDS consumers still live in an integrated way, but the issue should be addressed in a deliberative fashion.

What Are Harbor Village and Shannon's Mountain?

Harbor Village Includes 564 Housing Units on Fairview Developmental Center (DC) Property. In 1981, the Department of General Services (DGS) and the Department of Developmental Services (DDS) entered into a long-term ground lease with a private developer to develop residential housing on a 60-acre parcel within Fairview DC grounds. The lease and subsequent lease amendments authorized development of 564 housing units (apartments and some single-family detached units) at a complex named Harbor Village. The lease stipulated that units would be reserved first for Fairview DC employees and it also reserved a certain share for DDS consumers transitioning from Fairview DC into community living situations. Units could then be rented to individuals with incomes under 80 percent of the median income in Costa Mesa. Any remaining units could then be leased at fair market rates to people working in the City of Costa Mesa. Currently, DDS consumers occupy 177 units (31 percent).

The original lease terms did not require the developer to pay any monetary rent to the state and allowed it to receive a 15 percent return-on-investment (ROI) of hard costs related to construction, improvements, and management. A subsequent amendment established a small rental fee the developer must pay the state (currently about $9.30 per unit per month, or $5,251 total), with 85 percent going to DGS and 15 percent to DDS. In the early 2000s, the complex began generating surplus rental revenues above costs and ROI. The lease was amended to stipulate that surplus rental proceeds would be split evenly between the developer and DDS up to a $21.2 million cumulative total. DDS has used its portion of the surplus to modify and renovate units to meet the particular needs of DDS consumers living at Harbor Village and to subsidize the rents of DDS consumers living at Harbor Village. (Typically when a DDS consumer lives in his or her own apartment, DDS does not subsidize rent payments, except in certain circumstances authorized by statute.) DDS expects cumulative surplus rental proceeds to reach the cumulative $21.2 million cap in 2019-20 or 2020-21, after which 100 percent of surplus rental proceeds will flow to DDS. DDS expects to receive about $1.9 million annually in surplus when that happens. Chapter 23 of 2015 (SB 82, Committee on Budget and Fiscal Review) requires DDS to deposit these proceeds in a trust fund in the State Treasury and use it provide affordable housing and transitional services for people with developmental disabilities. DDS has interpreted Chapter 23 to mean surplus proceeds above what it uses to subsidize rent and renovate units for DDS residents at Harbor Village. The long-term lease expires in 2036 at which time Harbor Village will revert to full state ownership.

Shannon's Mountain Will Provide an Additional 332 Apartments at Fairview DC. Chapter 23 authorized DGS and DDS to develop another 20 acres on Fairview DC property for mixed-income housing through a 55-year lease. DGS and DDS have worked with the City of Costa Mesa on zoning rules and other local issues to move the project forward. The parcel, known as Shannon's Mountain, will include 332 housing units and must guarantee a minimum of 20 percent of units for DDS consumers. Chapter 23 authorizes DDS to use rental proceeds to subsidize the rents of DDS consumers. DGS will soon solicit proposals from housing developers to start the project. Shannon's Mountain will be modeled after the Harbor Village complex, although the exact terms of the lease, including the incentive structure for the private developer, will be negotiated through the procurement and contracting process.

Although it is conceivable to develop at least one residential housing complex at Sonoma DC, it may not be an ideal location for DDS consumers to live because it is not close to other established services such as community-based day programs and health care services. If mixed-income housing is pursued at Sonoma DC, care should be given to ensure that DDS consumers have access to good transportation options or that new services are developed close by.

The more remote location of the general treatment area of Porterville DC (and its close proximity to the secure treatment program that will remain) make it a relatively unlikely candidate for developing integrated community-based housing.

As mentioned previously, the primary purpose of developing mixed-income housing on DC properties would likely not be to raise revenues, but to provide residential options for DDS consumers and other Californians (both low-income and otherwise). Still, this option would likely result in at least some revenues from rental proceeds, providing an ancillary benefit to DDS. The state should not necessarily expect revenues to result quickly, however. At Harbor Village, it took about 30 years for rental proceeds to translate into surplus revenue for DDS (which may reach about $1.9 million annually in the next two years).

LAO BOTTOM LINE ON OPPORTUNITIES TO GENERATE REVENUES FROM DC CLOSURE PROPERTIES

Each of the remaining closure DCs has unique characteristics that will affect the state's ability to generate revenues from the sale or leasing of properties. Sonoma DC and Fairview DC present the most fertile opportunities for revenue generation, but developing on these properties (by a private buyer or by a private entity through a lease with the state) would require close collaboration with local governments and communities given local zoning, local preferences, and required voter approval of development projects. The general treatment area of Porterville DC is a relatively unlikely candidate for commercial or residential housing development, particularly given its relatively remote location and its close connection with the adjacent secure treatment program (including shared utility infrastructure and support facilities).

OTHER ISSUES FOR LEGISLATIVE CONSIDERATION

In addition to deciding how to assess net operational savings from closing DCs and generate revenues from the sale or leasing of these properties, the Legislature should consider other practical implications of the concept of the proposal being analyzed in this report.

Other States Are Grappling With Similar Issues in Their Developmental Services Systems

We note that a number of other states are grappling with issues similar to those raised in the proposal—the closure of institutional-like settings for individuals with developmental disabilities and the potential to generate savings that can then be used to expand coverage, improve upon services in the community for this population, or fund other state priorities. The box on page 14 provides key insights based on the experience of other states in dealing with these issues.

Does the Current Legislature Want to Tie the Hands of Future Legislatures?

Sequestering Savings Could Provide a Potential Source of Dedicated Funding for DDS . . . We have identified possible net savings in operational spending and ways to raise revenues through the sale or leasing of DC properties. The Legislature could dedicate this funding to DDS and set its priorities for how it should be spent. If the Legislature decides that the DDS community services program would benefit from targeted additional investment in certain areas, this "new" stream of funding could address those funding requirements.

. . . Yet Doing So Constrains the Ability of Future Legislatures to Make Budget Decisions. Constitutional mandates, voter initiatives, federal matches, and other decisions to earmark funds for specific purposes restrict the ability of the Legislature to respond to new or changing budgetary conditions. Past decisions constrain a significant share of the spending in the current state budget. The proposal under discussion in this report would be another example of constraining future legislative budgetary decisions by earmarking the use of net operational savings or revenues from DC closures to be spent in the DDS system.

Legislature Always Has the Choice to Increase Funding for DDS Community Services. Regardless of whether the Legislature decides to tie additional spending in DDS community services to "savings" from DC closures, it can decide at any time to increase DDS funding. For example, in 2016-17, it provided DDS nearly $300 million in additional funding from the General Fund to address identified unmet funding requirements in the DDS system. Importantly, the Legislature does not have to tie future funding decisions to a complicated formula that may or may not even result in significant operational savings.

How Would the Legislature Effectively Target Savings if Dedicated to the DDS System?

As mentioned at the beginning of this report, Assembly Member Mathis's proposal would specifically earmark savings/new revenues for the DDS community services program. Should the Legislature choose to earmark the savings in this way, there are several issues for its consideration.

Legislature May Want to Establish Special Fund and Determine Its Appropriate Uses. Should the

Key Insights From Other States

Calculation of Net Operational Savings Appears More Relevant in States With Waiting Lists. California is one of the only states in the nation that provides entitlement-like services to every individual with a qualifying developmental disability. In contrast, most states budget a limited amount of funding to their programs for people with developmental disabilities (sometimes just enough to meet federal funding matching requirements) and consequently maintain waiting lists for services. By controlling growth in caseload, these states can control growth in costs. This feature makes it more relevant in some ways for these states, such as Maryland (which currently has about 8,000 people on its waiting list), to annually calculate the net operational savings that result from institutional closures because they typically use the net operational savings to take people off the waiting list without incurring additional state costs. Officials in New Jersey—which, like California provides services essentially as an entitlement—indicated to us that New Jersey does not go through the annual exercise of calculating net operational savings. This was stated to be because any savings from institutional closures are almost always overwhelmed by increased costs due to year-over-year program growth in its community services program that occurs on the natural.

Use of Calculated "Savings" From Institutional Closures Varies. Our review of several other state's experiences found that the use of savings from institutional closures varied, reflecting the varying policy priorities of these state's respective Legislatures. For example, New Jersey deposits any proceeds from the sale of institutional properties into the state's General Fund rather than earmarking it for developmental services. However, New Jersey officials indicated to us that sales of its institutional properties tend to be difficult because of property location and the cost associated with tearing down aging facilities. On the other hand, some states dedicate savings to be used in the developmental services system, although the uses vary across states. For example, revenues raised from the sale of institutional properties in Maryland get deposited into a trust fund. The state does not spend the principal, but uses the interest to pay for community-based services for people with developmental disabilities. Virginia uses revenues raised by selling or leasing state-owned institutional properties to pay for one-time community service development and for the cost of transitioning institutionally-based residents to the community.

Legislature decide to dedicate net operational savings or revenues from the sale or leasing of closure DC properties for DDS use, it may want to have the funding from the savings/revenues deposited in a special fund. To achieve whatever its goals may be, the Legislature should decide on its priorities for spending from, and eligible uses of monies in, that special fund. To maintain legislative oversight, we would recommend that spending from the special fund require legislative approval in the annual budget process.

Ongoing or One-Time Uses of Special Fund Should Align With the Ongoing or One-Time Nature of the Funding Source. While both net operational savings and lease revenues represent ongoing sources of funding, proceeds from the sale of a DC property represent a one-time source of funding. (If, however, the principal from a sale were invested, it could earn interest, an ongoing source of revenue. Similarly, the principal could be gradually spent down over time, effectively turning it into a longer-term funding source.) As the Legislature determines appropriate uses of the special fund, it should consider whether a cost to be funded is ongoing or one-time in nature. If the Legislature authorized DDS to use the special fund for ongoing costs, it runs the risks of creating future fiscal pressures unless these authorized uses are aligned with an ongoing source of funding. (An example of an ongoing cost would be the restoration of the social and recreational activity program benefit that had been eliminated in tight budgetary times.) When the source of funding is one-time in nature, it would be fiscally prudent for the Legislature to target the use of such funding to one-time expenses. This latter approach can still be used to benefit the DDS system, but without committing the state to costly ongoing expenses. An example of one-time or limited-term spending would be the provision of development funds to help service providers get a program up and running in a geographic area where service gaps have been identified.

Community Service Gaps Need to Be Better Understood to Effectively Target DC Closure Savings. If the Legislature were to adopt a proposal to earmark funding from the closure of DCs for DDS community services, it would want to consider how to target the spending of these resources effectively. It may have difficulty prioritizing spending decisions, however, because gaps in service provision in the community are not fully understood. This is a challenge for the Legislature regardless of whether it adopts a proposal to earmark funding from DC closure savings. Although the system is structured through the IPP process ideally to account for and fund each individual's needs, it is a commonly held view that RCs struggle to help consumers find certain services, such as affordable, accessible, and safe housing; regular dental care; employment opportunities; and transportation. It is currently difficult to quantify the full extent of any service gaps since DDS lacks a standardized method for understanding these gaps on a systemwide basis. At best, DDS may know anecdotally that certain services are hard to find or that certain providers are going out of business. Accordingly, no matter what action the Legislature takes on the proposal under consideration, it would benefit from directing that there be a comprehensive assessment of service gaps and related unmet funding requirements in the community services system. Such assessment would help guide the use of any additional resources provided for this system.

CONCLUSION

We estimate the state could realize up to $100 million in net annual operational savings upon full closure of designated facilities.

While it is unclear how much revenue could be generated from the sale or leasing of DC properties, such actions—while presenting challenges—could provide a funding source to make additional investments in the DDS community services program should the Legislature so choose. To maximize the revenue-raising potential, the Legislature would likely have to bypass the typical process for disposing of surplus state property and work closely with local governments to ensure appropriate zoning rules are in place. Should the Legislature choose to sell properties, it should also decide whether DDS can spend down the principal or only spend the interest earned.

As the Legislature makes decisions about the potential savings that may result from DC closures, we think that it should consider the policy trade-offs of tying the hands of future Legislatures by dictating future spending decisions regarding the use of these savings. Should the Legislature choose to earmark the savings for DDS purposes, it may want to target such funding based on its priorities and having directed that there be a comprehensive assessment of service gaps and related unmet funding requirements in the community services program.

LAO PUBLICATIONS

This report was prepared by Sonja Petek and reviewed by Mark C. Newton. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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