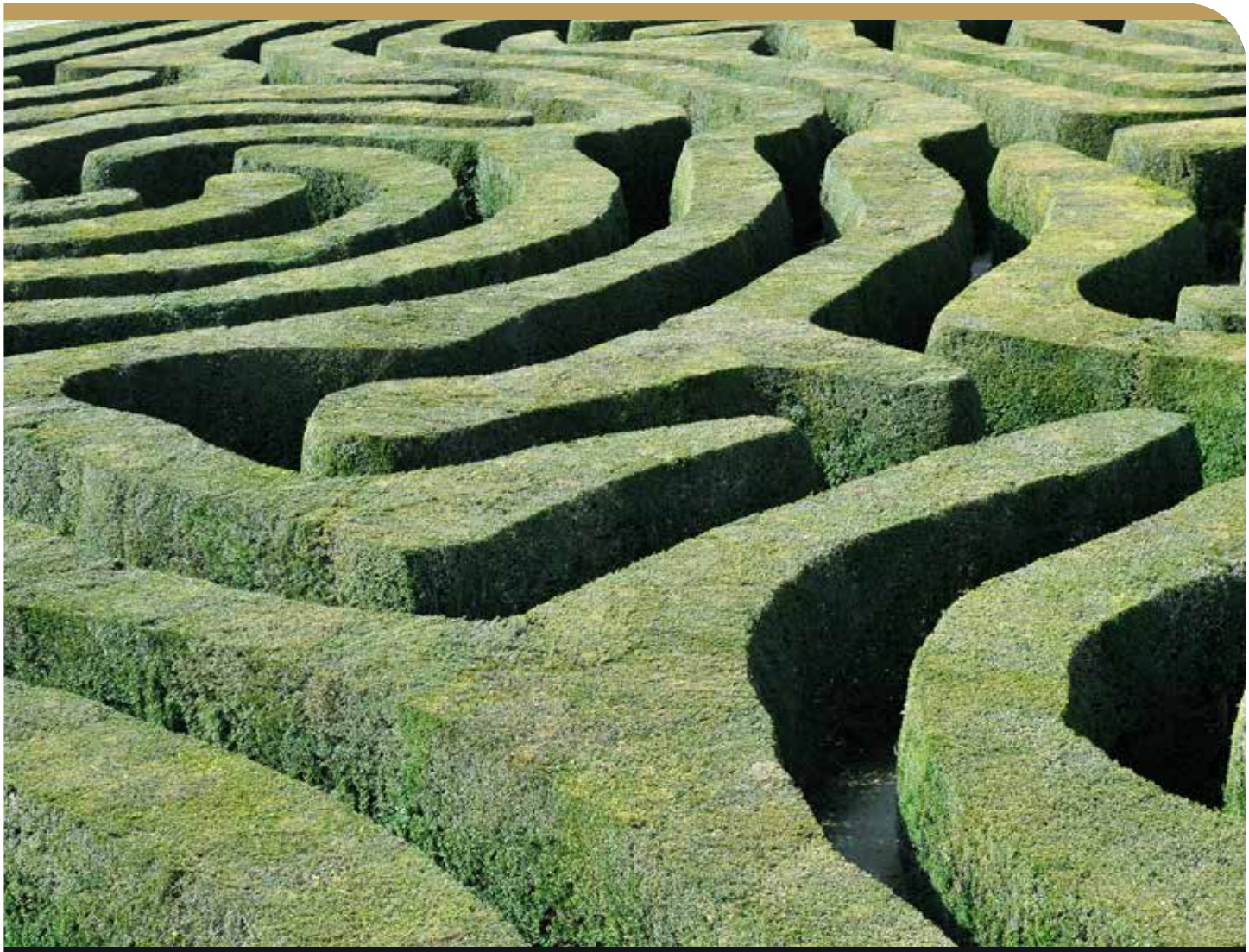

The 2019-20 Budget:

Assessing the Governor's 1991 Realignment Proposals

GABRIEL PETEK
LEGISLATIVE ANALYST
MARCH 8, 2019

LAO

Executive Summary

The Impetus for This Report. In 1991, the Legislature shifted significant fiscal and programmatic responsibility for many health and human services programs from the state to counties—referred to as 1991 realignment. Many changes have been made to this system over the last 28 years. Most recently, the *2017-18 Budget Act* made significant changes to how the state and counties share in the cost of In-Home Supportive Services (IHSS). As a result of these changes, the funding provided to counties for 1991 realignment responsibilities would no longer fully cover counties' costs. Consequently, the budget agreement required the Department of Finance (DOF) to review and report on the funding structure of 1991 realignment as part of its January 2019 budget proposal.

After reviewing the funding structure and cost and revenue growth, DOF concluded that the amount of revenue available under 1991 realignment cannot support counties' existing share of costs. As a result, the *2019-20 Governor's Budget* proposes a number of changes to 1991 realignment. This report evaluates the changes the Governor proposes and assesses whether the changes better position 1991 realignment to achieve its intended benefits and meet the principles of a successful state-county fiscal partnership.

Governor's Proposal. The Governor proposes changes to 1991 realignment related to IHSS, health, and mental health, summarized in the figure below.

Governor Proposes Reasonable Approach for Bringing 1991 Realignment Into Financial Balance. Our office and the administration agree that 1991 realignment today no longer meets many of the core principles of a successful state-county fiscal partnership. We find that the *2019-20 Governor's Budget* proposes a reasonable approach for bringing 1991 realignment into financial balance. In particular, the proposed rebasing of the IHSS county maintenance-of-effort and lower annual adjustment factor make significant progress to align counties' costs with their realignment revenues and protect counties against significant future increases in program costs. However, whether realignment revenues will be sufficient to cover counties' costs long term is

Key Features of the Governor's 2019-20 Realignment Package

Proposals
IHSS-Related Changes
• Rebase IHSS county MOE to lower amount in 2019-20
• Lower the annual adjustment factor for IHSS county MOE beginning in 2020-21
• Eliminate General Fund assistance for IHSS county MOE and redirected VLF growth funds
• Increase county share of cost for locally established IHSS wage and benefit increases once state minimum wage reaches $15.00 per hour
Health and Mental Health-Related Changes
• Increase redirection of realignment funding for health from 60-percent counties to state
• Temporarily eliminate growth allocations to CMSP
• Establish fixed general growth allocation among mental health and CalWORKs

IHSS = In-Home Supportive Services; MOE = maintenance-of-effort; VLF = vehicle license fee CMSP = County Medical Services Program; and CalWORKs = California Work Opportunity and Responsibility to Kids.

unclear. We recommend the Legislature monitor whether realignment revenues are sufficient to cover counties' IHSS costs over time.

State IHSS Costs Will Increase More Over Time. While the Governor's budget proposal alleviates IHSS-related costs pressures for counties, it does so by increasing state costs. While a higher state share of IHSS costs is appropriate, the state's ability to control the increasing cost pressures associated with IHSS is limited. Thus, the Legislature should consider how to best plan for the impact of a growing senior population on the state budget.

Implications of Health and Mental Health-Related Changes. Because of counties' reduced responsibility over low-income, uninsured residents since the Patient Protection and Affordable Care Act and the Governor's proposal to expand eligibility for comprehensive Medi-Cal coverage to income-eligible undocumented immigrants ages 19 through 25, we find that an increase in the redirection of realignment revenues from counties to the state likely is appropriate. However, we have concerns about the proposed redirection's magnitude and scope. We also are concerned that the Governor's proposal does not address ongoing uncertainty about key issues. Accordingly, we recommend the Legislature (1) consider the impact on public health funding when evaluating the Governor's proposal; (2) consider the continued viability of the County Medical Services Program given revenue changes proposed by the Governor and decreasing low-income, uninsured population; and (3) assess alignment of funding for county health and mental health with county responsibilities.

INTRODUCTION

California has shifted programmatic and funding responsibility between the state and counties for various programs over the last 40 years. Historically, these shifts—or realignments—aimed to benefit both the state and counties by providing greater local flexibility over services, allowing counties opportunities to innovate and improve program outcomes, and encouraging cost savings by requiring counties to share in program costs. In particular, the 1991 realignment package: (1) transferred several programs and responsibilities from the state to counties, (2) changed the way state and county costs are shared for certain human services programs, (3) transferred health and mental health service responsibilities and costs to the counties, and (4) increased the sales tax and vehicle license fee (VLF) and dedicated these increased revenues to the new financial obligations of counties for realigned programs and responsibilities.

Since 1991, this realignment has gone through a number of structural and programmatic changes. Most recently, the *2017-18 Budget Act* made significant changes to how the state and counties share in the cost of the In-Home Supportive Services (IHSS) program, by far the costliest human services program in 1991 realignment. As a result of these changes, the funding provided to counties for 1991 realignment responsibilities would no longer fully cover counties' costs. Consequently, the budget agreement required the Department of Finance (DOF) to review and report on the funding structure of 1991 realignment as part of its January 2019 budget proposal.

In anticipation of the DOF report, we published a report in October 2018, *Rethinking the 1991 Realignment*, that outlined key historical fiscal and programmatic changes made to 1991 realignment that go beyond the more recent changes to the IHSS financing structure. We also discussed how these changes generally increased program costs among existing realigned programs and expanded program responsibilities within 1991 realignment. Ultimately, we found that 1991 realignment today no longer meets many of the core principles of a successful state-county fiscal partnership and provided the Legislature with some options to consider to improve 1991 realignment.

DOF reached similar conclusions in its recently released report, *Senate Bill 90: 1991 Realignment Report*. Specifically, after reviewing the funding structure and cost and revenue growth, DOF concluded that the amount of revenue available under 1991 realignment cannot support counties' existing share of costs. As a result, the *2019-20 Governor's Budget* proposes a number of changes to 1991 realignment.

This report evaluates the changes the Governor proposes and assesses whether the changes better position 1991 realignment to achieve its intended benefits and meet the principles of a successful state-county fiscal partnership we identified in our October report.

BACKGROUND

What Is Realignment? Realignments change the administrative, programmatic, and/or fiscal responsibility for programs between the state and the counties. Most realignments have shifted responsibility and resources from the state to counties. These realignments have affected responsibility for many program areas including criminal justice, health and mental health, child welfare, and the California Work Opportunity and Responsibility to Kids (CalWORKs) program. The State Constitution requires the state to reimburse local governments for state-required programs and services. As a result, when realigning administrative, programmatic, or fiscal responsibility from the state to counties, the state must provide counties with funds to cover the cost of those increased responsibilities. Rather than reimburse counties based on their actual costs, the state

typically provides counties specific revenue sources—like a portion of the sales tax—to pay for their increased fiscal responsibilities (share of cost) under realignment.

Benefits and Principles of Realignments. Realignments are intended to have long-term benefits for counties by providing (1) greater local flexibility over programs and services based on local needs and (2) incentives to encourage counties to innovate to achieve better program outcomes. Better program outcomes also benefit the state fiscally because counties' service improvements have the potential to reduce overall costs. Moreover, with a share of cost, counties have an incentive to control program costs in areas over which they have more control (like administration). To achieve these benefits, we believe realignments need to follow certain core principles. Below we identify what we believe these core principles to be.

- ***Counties' Share of Costs Reflect Their Ability to Control Costs in the Program.*** Realignments should aim to align the state's and counties' share of cost based on their relative control over those programs. That is, counties should be financially responsible over those program aspects for which their decisions affect cost.
- ***Revenues Generally Cover Costs Over Time.*** In some years, the revenues the state provides may exceed counties' costs. In other years, the revenues provided by the state may not be sufficient to cover counties' costs. Over time, however, the revenue provided is intended to generally cover counties' costs for their required realigned program responsibilities.
- ***Flexibility to Respond to Changing Needs and Requirements.*** Funding allocations should be sufficiently flexible to allow counties to use funding where it is most needed.
- ***Funding Is Transparent and Understandable.*** The funding provided to counties should be easily understandable. Total program funding also should be easily known.

1991 Realignment Basics. In 1991, the Legislature shifted significant fiscal and programmatic responsibility for many health and human services programs from the state to counties—referred to as 1991 realignment. The 1991 realignment package: (1) transferred several programs and responsibilities from the state to counties, (2) changed the way state and county costs are shared for certain social services programs, (3) transferred health and mental health service responsibilities and costs to the counties, and (4) increased the sales tax and VLF and dedicated these increased revenues to the new financial obligations of counties for realigned programs and responsibilities. Today, counties receive about $6.5 billion (over $3 billion from sales tax, $2 billion from VLF, and about $1 billion transferred from another realignment for mental health) through 1991 realignment.

While 1991 realignment moved in the right direction to better align county costs with their level of program control and create better fiscal incentives for counties, many changes have been made to this system over the last 28 years. These changes fall into two main categories: cost impacts and revenue changes. Impacts to cost mainly have been driven by changes to program rules and responsibilities or increases in caseload. For example, IHSS costs have significantly increased since 1991, in part, due to significant caseload growth and policy changes that have made the program more costly. Revenue changes have been due to state actions. While the state did not increase realignment revenues in response to cost impacts that increased costs (or directly reduce counties' share of program costs), the state has redirected revenues when realignment costs went down. For example, the Patient Protection and Affordable Care Act (ACA) significantly reduced counties' low-income health responsibilities that were funded through realignment. As a result, the state required counties to redirect freed-up realignment revenues to the state. These freed-up revenues directly offset state costs for CalWORKs grants and county administration thereby making resources available for the new state costs associated with the ACA.

1991 Realignment No Longer Meets Many LAO Principles. Due to the various changes to 1991 realignment programs without corresponding changes to the funding structure, 1991 realignment today no longer meets many of the core principles of a successful state-county fiscal partnership. Today, counties' share of some program costs exceeds their ability to control those costs. In addition, overall realignment revenues are not sufficient to cover the costs of those programs over time. Lastly, the flow of funds in realignment is extremely complex and not flexible enough to allow counties to respond to changing needs and requirements. As a result, 1991 realignment likely is not achieving the desired benefits. (Refer to our recent report, *Rethinking the 1991 Realignment*, for a comprehensive description of 1991 realignment, the key changes to the system in subsequent years, and our analysis for why 1991 realignment no longer meets many of the core principles of a successful realignment.) In the sections below, we describe and assess the Governor's proposed changes to 1991 realignment.

OVERVIEW OF THE GOVERNOR'S PROPOSAL

In its January 2019 report, *Senate Bill 90: 1991 Realignment Report*, DOF found the amount of revenue available under 1991 realignment cannot support the costs of the current programs within the realignment. As we discussed previously, we reached the same conclusion in our report, *Rethinking the 1991 Realignment*. In response to the findings of its report, the administration proposed a number of changes to 1991 realignment summarized in **Figure 1**. Below we describe the proposed changes.

IHSS-Related Changes

History of IHSS County Costs. Historically, counties paid 35 percent of the nonfederal—state and county—share of IHSS *service* costs and 30 percent of the nonfederal share of IHSS *administrative* costs. Beginning in 2012-13, however, the historical county share of cost model was replaced with an IHSS county maintenance-of-effort (MOE), meaning county costs would reflect a *set amount* of nonfederal IHSS costs as opposed to a *certain percent* of nonfederal IHSS costs. In 2017-18, the initial IHSS MOE was eliminated and replaced with a new county MOE financing structure—referred to as the 2017 IHSS MOE. (For further information on the development of the 2017 IHSS MOE, refer to our report, *The 2017-18 Budget: The Coordinated Care Initiative: A Critical Juncture*.) Under the 2017 IHSS MOE,

Figure 1

Key Features of the Governor's 2019-20 Realignment Package

Proposals
IHSS-Related Changes
• Rebase IHSS county MOE to lower amount in 2019-20
• Lower the annual adjustment factor for IHSS county MOE beginning in 2020-21
• Eliminate General Fund assistance for IHSS county MOE and redirected VLF growth funds
• Increase county share of cost for locally established IHSS wage and benefit increases once state minimum wage reaches $15.00 per hour
Health and Mental Health-Related Changes
• Increase redirection of realignment funding for health from 60-percent counties to state
• Temporarily eliminate growth allocations to CMSP
• Establish fixed general growth allocation among mental health and CalWORKs

IHSS = In-Home Supportive Services; MOE = maintenance-of-effort; VLF = vehicle license fee CMSP = County Medical Services Program; and CalWORKs = California Work Opportunity and Responsibility to Kids.

the counties' share of IHSS costs was reset to roughly reflect the counties' share of estimated 2017-18 IHSS costs based on historical county cost-sharing levels (35 percent of the nonfederal share of IHSS service costs and 30 percent of the nonfederal share of IHSS administrative costs). Additionally, the 2017 IHSS MOE increased annually by (1) an adjustment factor (which, depending on realignment revenue growth, could be 5 percent or 7 percent) and (2) counties' share of costs from locally established wage increases. (For example, over the past five years, total IHSS county MOE costs have increased from less than 1 percent to 4 percent annually as a result of locally established wage increases for IHSS providers.)

2017 IHSS MOE Exceeded Realignment Revenue Available. When the 2017 IHSS MOE was implemented, there was concern that realignment revenues would no longer cover counties' share of costs. In fact, the 2017 IHSS MOE exceeded realignment revenues by about $530 million (though temporary General Fund assistance and redirected VLF revenues were provided to counties to mitigate the majority of this shortfall). Moreover, there was concern that realignment revenues would never "catch-up" to pay for increasing IHSS county costs in future years because revenues were not growing as fast as the annual adjustment factor.

Key Proposals to Address IHSS Costs. The DOF report found that 1991 realignment could no longer support counties' IHSS costs primarily because of programmatic changes that have made IHSS more costly over time and reduced the state's and counties' ability to control program costs. To address this problem, the administration proposes to restructure the IHSS MOE so that counties' share of cost better reflects their ability to control costs and revenues generally cover counties' IHSS costs over time. Below, we describe in detail these changes. (The Governor's budget also proposes technical changes to how certain realignment revenues flow to counties and what program costs are included in the IHSS MOE.)

- ***Rebase IHSS County MOE to Lower Amount in 2019-20.*** The budget proposes to reduce the IHSS MOE from $2 billion to $1.56 billion in 2019-20. It is our understanding that the administration determined the changes to the IHSS MOE based on what realignment revenues could support in 2019-20. The administration indicates it will revise the MOE reduction in May based on updated estimates of realignment revenues.
- ***Lower the Annual Adjustment Factor Beginning in 2020-21.*** Under current law, the IHSS MOE increases by 5 percent or 7 percent annually (depending on the growth in realignment revenues) and counties' share of costs from locally established wage increases. The budget proposes to lower the annual adjustment factor to 4 percent beginning in 2020-21. The IHSS MOE will also continue to increase annually by counties' share of costs from locally established wage increases.
- ***Eliminate General Fund Assistance and End Redirection of Health and Mental Health VLF Growth Funds.*** Current law provides substantial General Fund assistance to counties to mitigate the cost of the 2017 IHSS MOE—$400 million beginning in 2017-18 and declining to $150 million by 2020-21. Additionally, counties temporarily are receiving VLF revenue that would otherwise go to health and mental health programs to partially cover counties' IHSS costs. Given the Governor's proposal to significantly reduce the cost of the IHSS MOE, the budget proposes to eliminate the temporary General Fund assistance and stop the redirection of VLF revenue beginning in 2019-20.
- ***Increase County Share of Cost for Locally Established IHSS Wage and Benefit Increases Once State Minimum Wage Reaches $15.00 Per Hour.*** Under current law, counties pay for 35 percent of the nonfederal costs associated with locally established IHSS wage and benefit increases and the state pays for the remaining 65 percent up to the state participation cap ($13.10 per hour in 2019). Counties pay for 100 percent of costs over the state participation cap. (Currently, the state participation cap increases as the state minimum wage increases, remaining

$1.10 per hour above the state minimum wage.) Once the state minimum wage reaches $15.00 per hour (scheduled to occur on January 1, 2022), the budget proposes to (1) increase the counties' share of nonfederal costs associated with locally established IHSS provider wage and benefit from 35 percent to 65 percent (with the state paying for the remaining share of cost) and (2) eliminate the state participation cap.

Health and Mental Health-Related Changes

Counties Receive Separate Realignment Revenue Streams for Health and Mental Health. Through 1991 realignment, the state provides flexible health realignment funding for counties to (1) provide health care services to their uninsured, low-income populations and (2) carry out local public health activities. The state also provides separate funding through 1991 realignment for mental health services. For the most part, there was no preexisting statewide model counties have to follow for mental health service responsibilities. Counties had greater flexibility to establish a local program structure and administer these service responsibilities independent of what other counties were doing, based on the mental health needs of their county residents.

Redirection of Health Realignment Revenues Currently Offsets General Fund Costs in CalWORKs. Following the implementation of the ACA in 2014, the number of low-income Californians without health care coverage decreased dramatically. This reduced counties' costs for health care services for this population and increased state costs. In response, the state redirected health realignment funding to pay for an increased county share of costs in the CalWORKs program, which provides cash grants and employment services to low-income families. The increased county share of cost directly offsets General Fund spending, thereby lowering state costs.

Approaches for Determining Counties' Redirection of Health Realignment Revenues. At the time of ACA implementation, the state identified two distinct approaches for determining the amount of health funding to redirect from counties to CalWORKs. Certain counties—primarily rural counties that jointly administer health care services for their uninsured, low-income populations as part of the County Medical Services Program (CMSP)—were required to redirect 60 percent of the funding they would have received for overall health activities (health care and public health). Twelve counties were required to redirect their realignment health funding according to a formula that accounts for net changes in county health care costs since the ACA. The remaining 12 counties were given the option to decide whether to redirect 60 percent of funding or use the formula approach. While formula redirection is intended to more precisely account for the reduction in counties' health care costs, the formula is administratively burdensome to manage. In contrast, the 60 percent redirection is not precise. Counties may redirect more or less of their health care revenue to the state than their actual experience may warrant. This approach, however, does not create the administrative challenges observed in the formula redirection. Five counties chose the 60 percent redirection approach. Current law prevents counties from changing their redirection approach. **Figure 2** (see next page) shows the redirection approach used for each county.

Administration Proposes to Increase Redirection of Realignment Funding for Health From "60-Percent" Counties to State. The Governor proposes to expand eligibility for comprehensive Medi-Cal coverage to income-eligible undocumented immigrants ages 19 through 25. In connection with this proposal, the Governor also proposes to increase the redirection of county realignment funding for health from 60 percent to 75 percent in 60-percent redirection counties. (Refer to our recent report, *The 2019-20 Budget: Analysis of the Medi-Cal Budget*, to learn more about the Governor's proposed Medi-Cal expansion.) This proposal is intended to defray a portion of the General Fund cost (estimated to be $63 million) of expanding Medi-Cal coverage by redirecting what the administration assumes the counties would otherwise spend on health care services for their uninsured, low-income

populations. (As we describe later, we think this actually reflects more county savings than likely to be experienced under the Governor's proposal.)

Temporarily Eliminate Growth Allocations to CMSP. Under 1991 realignment, the CMSP program receives a separate allocation of health realignment revenues to cover the costs of providing health care services to the uninsured residents of participating counties. Counties that participate in CMSP also receive their own allocation of health realignment revenues, but this funding is used to support public health activities that are not administered by the CMSP program. As CMSP health care costs have declined since the ACA, CMSP has built up a large reserve of over $360 million—more than ten times its annual operating budget. Beginning in 2019-20, the Governor proposes to eliminate any growth in the allocation of health realignment revenue to CMSP until its operating reserves fall below those required to sustain operations for three months. (These realignment revenues would instead be allocated using the "general growth" process we describe below.)

Figure 2

State Has Two Main Approaches for Redirecting Health Realignment Revenues

60 Percent Redirection		
CMSP Counties	**Non-CMSP Counties**	**Formula Redirection**
Alpine	**Placer**[a]	Alameda
Amador	**Sacramento**[a]	Contra Costa
Butte	**Santa Barbara**[a]	**Fresno**[a]
Calaveras	**Stanislaus**[a]	Kern
Colusa	**Yolo**[a,b]	Los Angeles
Del Norte		**Merced**[a]
El Dorado		Monterey
Glenn		**Orange**[a]
Humboldt		Riverside
Imperial		San Bernardino
Inyo		**San Diego**[a]
Kings		San Francisco
Lake		San Joaquin
Lassen		**San Luis Obispo**[a]
Madera		San Mateo
Marin		Santa Clara
Mariposa		**Santa Cruz**[a]
Mendocino		**Tulare**[a]
Modoc		Ventura
Mono		
Napa		
Nevada		
Plumas		
San Benito		
Shasta		
Sierra		
Siskiyou		
Solano		
Sonoma		
Sutter		
Tehama		
Trinity		
Tuolumne		
Yuba		

[a] These counties had the option of choosing either the 60 percent redirection or the formula redirection.
[b] Yolo County joined CMSP in 2011. For purposes of redirection of health realignment revenue, Yolo County is treated as a non-CMSP county.
CMSP = County Medical Services Program.

Establish Fixed General Growth Allocation Among Mental Health and CalWORKs. Under current law, annual growth in realignment revenues are allocated in a series of steps. First, growth is allocated to cover cost increases in certain caseload-driven programs, such as IHSS. Second, CMSP receives a portion of the remaining growth according to a statutory formula. Third, any remaining growth is split among health, mental health, and CalWORKs for increases to grants. This third step is referred to as general growth. Today, the share of general growth allocated to mental health depends on an annually updated schedule determined through a complex series of calculations involving various historical allocations. Health programs receive a fixed share of about 18 percent of general growth. Although the share of

general growth allocated to mental health has varied slightly in recent years, it generally has been close to 37 percent. The remaining general growth is allocated to defray General Fund costs on increased CalWORKs grants. The Governor proposes to set these percentages in statue moving forward—about 37 percent for mental health, about 44 percent for CalWORKs, and about 18 percent for health.

KEY ISSUES FOR LEGISLATIVE CONSIDERATION

This section analyzes the Governor's proposals on 1991 realignment and raises issues for Legislative consideration. **Figure 3** (see next page) summarizes how the Governor's proposals address our realignment principles and provides our assessment of those proposals.

Proposed IHSS MOE Changes Improve 1991 Realignment Structure

Proposed Changes to IHSS MOE Better Align 1991 Realignment With LAO Realignment Principles. Based on our realignment principles, realignment revenues should generally cover program costs over time and counties' share of program costs should reflect their ability to control those programs. Below we describe how the Governor's proposed changes improve alignment of 1991 realignment with our principles.

- As a result of the proposed reduction to the IHSS MOE, realignment revenues are expected to fully cover county costs in the near term. Additionally, the proposed lower adjustment factor improves the chances of realignment revenues covering county costs over time.
- Even though the proposed reduction to the IHSS MOE is based on what realignment revenues can support, rather than an analysis of counties' ability to control IHSS cost, we believe that the proposed reduction moves in the right direction and more accurately reflects counties' ability to control IHSS costs today.
- The proposed increase to counties' share of nonfederal costs for county negotiated and established wage and benefit increases (from 35 percent to 65 percent) seems to right-size counties' fiscal responsibility for a cost counties can control.
- The elimination of the temporary General Fund assistance and ending the redirection of VLF growth funds unwinds some of the complexity introduced by the 2017 IHSS MOE, thereby making modest improvements to the transparency and understandability of the 1991 realignment funding structure.

IHSS MOE Financing Model Reduces Financial Risk to Counties. The IHSS MOE financing model offers counties protection against significant future increases in program costs. While the proposed IHSS MOE adjustment factor (4 percent) generally reflects recent growth in realignment revenues year to year, it is far lower than the average annual growth in total IHSS costs (11 percent). To the extent that total IHSS costs continue to grow at a faster rate than the proposed IHSS MOE adjustment factor, counties will be responsible for a decreasing share of total IHSS costs over time. As we discuss later, a trade-off of the significant reduction in counties' costs, however, is increased state costs.

Counties' Long-Term Financial Balance Less Certain. Whether realignment revenues will be sufficient to cover counties' costs long term is unclear. In 5 of the last 13 years, realignment revenues grew less than 4 percent (including years when realignment revenues did not grow or were negative). In all other years, primarily after the Great Recession, realignment revenue growth exceeded 4 percent. If in future years average growth in realignment revenue is lower than the IHSS MOE annual adjustment factor, IHSS county costs would exceed revenues. As a result, counties would face increasing cost pressures from their 1991 realignment responsibilities. We recommend the Legislature monitor—through the annual budget process—whether realignment revenues are sufficient to cover counties' IHSS costs over time.

State IHSS Costs Will Increase More Over Time

While the Governor's budget proposal alleviates IHSS-related costs pressures for counties, it does so by increasing costs pressures experienced by the state. Specifically, the administration estimates that the proposed reduction to the IHSS MOE and lower annual adjustment factor will shift, on net, $241.7 million in IHSS costs from counties to the state in 2019-20. Due to the increasing costs of the program, the net cost to the state is estimated to increase to $547.3 million by 2022-23. Below, we explain the growing cost trends associated with IHSS and the state's limited ability to control overall program costs.

IHSS Has Experienced Significant Growth in Program Costs and Caseload. Over the past five years, total IHSS costs have grown by 11 percent annually, on average. While the reasons for the significant growth in IHSS program costs are not completely understood, it may be attributable to

Figure 3

Summary of LAO's Assessment on Governor's Proposals

Governor's Proposal	Primary Principle Addressed	LAO's Assessment
IHSS-Related Changes		
Rebase IHSS County MOE	Counties' share of costs reflect their ability to control costs in the program.	Reduced share of cost in IHSS for counties is a move in the right direction. However, IHSS MOE is based on available revenue, rather than counties ability to control costs in the program.
	Revenues generally cover costs over time.	Realignment revenues would generally cover county costs, at least in near term, but would place significant and growing cost pressures on General Fund.
Lower the Annual Adjustment Factor for IHSS MOE	Revenues generally cover costs over time.	Lower adjustment factor generally aligned with recent growth in annual realignment revenues, thereby improving the chances of revenues covering total county IHSS costs over time. However, the adjustment factor is far less than average annual growth in IHSS costs, resulting in growing cost pressures on General Fund.
Eliminate General Fund Assistance and Redirected VLF Growth Funds	Funding is transparent and understandable.	Reasonable to eliminate General Fund assistance to counties given financial relief provided by rebased MOE and lower annual adjustment factor. Redirection frees up revenue for health, mental health, and CalWORKs. While complexity remains, these changes unwind some of the complexity introduced by the 2017 IHSS MOE.
Increase County Share of Cost for Locally Established IHSS Wage and Benefit Increases	Counties' share of costs reflect their ability to control costs in the program.	Increase to counties' share of nonfederal costs for county negotiated wage and benefit increases seems to right-size counties fiscal responsibility over a cost counties can control.
Health and Mental Health-Related Changes		
Increase Redirection for Health From 60-Percent Counties	Counties' share of costs reflect their ability to control costs in the program.	Additional redirection likely appropriate, but scope and magnitude of proposed redirection raises questions.
Temporarily Eliminate Growth Allocations to CMSP	Revenues generally cover costs over time.	Reasonable to limit CMSP revenue growth until reserves reduced, but raises concerns about right level of reserves.
Establish Fixed General Growth Allocation Among Mental Health and CalWORKs	Funding is transparent and understandable.	Eliminates need to prepare an annual schedule that is administratively burdensome to develop and fluctuates minimally from year to year thereby modestly reducing complexity.

IHSS = In-Home Supportive Services; MOE = maintenance-of-effort; VLF = vehicle license fee; CalWORKs = California Work Opportunity and Responsibility to Kids; and CMSP = County Medical Services Program.

growth in caseload and recent policy decisions that have made the program more costly. For example, over the past five years IHSS caseload growth has remained, on average, at 5 percent annually, increasing from 444,000 in 2014-15 to an estimated 564,000 in 2019-20. The growth in caseload could be related to the state's increasing senior population (adults aged 65 and older) and a growing preference to age at home. Additionally, a number of recent policy decisions, such as the implementation of state minimum wage increases and federal overtime rules, have made the operation of IHSS program more costly.

The State's Ability to Control Overall IHSS Cost Is Limited. Since 1991, IHSS largely has become an entitlement program. As a result, the state's and counties' ability to control program costs is limited. In the past, the state has attempted to reduce IHSS costs, but these attempts were largely not implemented. Specifically, during the recession, the state proposed a number of changes to IHSS intended to create budget savings, including the institution of stricter eligibility rules and reducing service hours by 20 percent. Multiple class action lawsuits were brought against the state to prevent these changes from taking effect, largely on the basis that they violated federal Medicaid rules and federal protections for persons with disabilities.

State's Financial Responsibility Over IHSS Expected to Increase. In general, IHSS is the state's largest community-based program that provides low-income seniors and people with disabilities with long-term services and supports (LTSS) so that they can remain safely in their homes. As the senior population continues to grow, utilization of the IHSS program may increase, resulting in the program becoming more costly over time. To the extent that this does occur, the state will, under the Governor's proposal, pay a higher share of the increased nonfederal IHSS costs. While a higher state share of IHSS costs is appropriate, the state's ability to control the increasing cost pressures associated with IHSS is limited. Thus, the Legislature should consider how to best plan for the impact of a growing senior population on LTSS programs, like IHSS, and the state budget.

Implications of Health and Mental Health-Related Changes

New IHSS MOE Frees-Up Realignment Revenues for Health, Mental Health, and CalWORKs. As previously mentioned, VLF growth funds within 1991 realignment for health, mental health, and CalWORKs are temporarily redirected to provide counties with additional funds to pay for the 2017 IHSS MOE. The administration estimates that counties will no longer need VLF growth funds to pay for IHSS county costs given the proposed reduction to the IHSS MOE in 2019-20. As a result, the budget proposes to stop the temporary redirection of VLF growth, meaning these funds will instead flow as intended to health and mental health realigned programs and offset state CalWORKs costs. Additionally, by reducing the IHSS MOE, the Governor's proposal frees-up sales tax growth for these programs. The administration estimates the increase in revenues for county mental health programs in 2019-20 to be about $70 million. The proposed changes also would result in additional growth funding for health programs of about $30 million.

An Additional Redirection to State From Health Funding Likely Is Appropriate . . . For CMSP and the other 60-percent redirection counties, the reduction of low-income, uninsured residents due to the ACA arguably resulted in greater county savings than the redirection policy anticipated. Caseload for CMSP, for example, fell by close to 99 percent—from around 90,000 before the ACA to around 1,000 today. Moreover, following implementation of the ACA, the state expanded comprehensive Medi-Cal coverage to income-eligible, undocumented children, further reducing counties' costs. The state did not redirect additional health realignment funding from CMSP and the other 60-percent counties for this expansion. (In contrast, formula counties' health funding adjusts automatically based on savings due to reduced caseload.) For these reasons, we find that an increase in the redirection of realignment revenues from counties to the state likely is appropriate.

. . . However, the Magnitude and Scope of Governor's Proposed Redirection Potentially Goes Too Far. Although we find that, *some* increase in the redirection is likely appropriate, we have concerns about the proposed redirection's magnitude and scope. The following bullets highlight several of our concerns:

- ***Increase in the Redirection Larger Than the Projected Reduction in the Uninsured.*** The projected proportional increase in Medi-Cal coverage as a result of the Governor's proposed expansion (and corresponding decrease in county health care service responsibilities) is smaller than the proposed percent increase in the realignment redirection. Under the coverage expansion, California's uninsured, low-income population would decrease by less than 10 percent, while the Governor's realignment proposal would reduce remaining health realignment funding by more than 25 percent. If the intent is to solely account for the savings associated with the proposed Medi-Cal expansion, the magnitude of the redirection proposed by the Governor may be too large.
- ***Redirection Affects Counties That Will Not See Realignment Savings From Governor's Medi-Cal Coverage Expansion.*** Some, including Placer and Santa Barbara Counties, do not use realignment dollars to offer health care coverage to low-income, uninsured, undocumented residents. (Instead, these counties use their health realignment funding for public health.) Expanding Medi-Cal to these residents will not free up realignment funding for these counties. Despite this, the proposal would redirect some of their health realignment funding to the state. This suggests that the scope of the redirection proposed by the Governor may be too broad.
- ***Potential Impact on County Public Health Activities.*** For the 60-percent counties that do not participate in CMSP and Yolo County (which is treated as if it does not participate in CMSP for purposes of the redirection), the proposed increase in the redirection applies to overall realignment funding provided directly to the counties for health programs, including for *both* health care services and public health activities. Some of these counties dedicate a significant share of their health realignment dollars to public health activities. Across the five counties, about $20 million of the $40 million in health realignment funding available is used for public health. For these counties, realignment dollars are often the only source of flexible public health funding. As such, the proposed increase in the redirection could cause these counties to have to scale back their public health activities. Across these five counties, the state currently redirects about $60 million. The Governor's budget would redirect an additional $15 million, about half of which currently supports public health activities. We recommend the Legislature consider the potential impact on core public health activities and decide whether it should backfill the loss. Longer term, we suggest the Legislature consider an evaluation of the role of local public health more generally to determine an appropriate amount of funding for these efforts and whether these efforts and funding levels should be considered separately from realignment.

Reasonable to Limit CMSP Revenue Growth Until Reserves Are Reduced, but Raises Questions About the Right Level of Reserves and Ongoing Viability of CMSP. We find the Governor's overall policy to eliminate the growth allocation for CMSP until its reserves are lower reasonable and worthy of serious consideration by the Legislature. The Governor's proposal to reduce CMSP reserves to three months of costs likely goes too far, however. During a recession, realignment revenues—sales tax and VLF—can decrease for many months. Without sufficient reserves, CMSP likely would have to reduce services for low-income, uninsured individuals in participating counties. While CMSP can operate in the near term by spending down its reserves, when CMSP's reserves eventually are spent down, it is not clear that new growth in realignment revenues going to CMSP would be enough to allow it to continue to operate. Additionally, as the number of low-income

state residents without health care coverage decreases, the role of CMSP is called into question. We suggest the Legislature consider the long-term financial plan for CMSP and its mission.

Establishing Fixed General Growth Allocation Among Mental Health and CalWORKs Reasonable, Makes Modest Improvements to Funding Transparency and Understandability. Understanding the flow of funds within 1991 realignment is very challenging. As a result of changes to 1991 realignment programs over the years, the tracking of realignment revenues and program expenditures has increased in complexity and the flow of funds is more labyrinthine. The Governor's proposal to set the share of general growth allocated to mental health programs at about 37 percent (and consequently setting the general growth allocation for CalWORKs), eliminates the need to prepare an annual schedule that is administratively burdensome to develop, and fluctuates minimally from year to year. This proposal and other aspects of the realignment package make modest improvements to the funding transparency and understandability of 1991 realignment.

Remains Unclear Whether Health and Mental Health Realignment Funding Is Aligned With Counties' Current Responsibilities . . . Counties have flexibility to determine how to allocate health and mental health services funding. Moreover, counties braid multiple funding sources together to meet their health and mental health priorities. As a result, determining whether funding is aligned with county responsibilities is very difficult. The Governor's proposal does not address this ongoing uncertainty.

- ***. . . For Mental Health.*** The administration's proposal does not address key structural issues within the state's financing of mental health services that make it difficult to determine whether overall county mental health funding is aligned with county mental health service responsibilities. Data on the total costs incurred by counties to provide mental health services and on how counties utilize different funding sources to pay for those services are not readily available.
- ***. . . For Local Public Health.*** The current amount of realignment funding available for public health activities is essentially a function of how much remains after the redirection and, subsequently, counties' choices on whether to dedicate the remaining funding to public health activities or health care services. Knowing the "necessary" or "right" amount to spend on public health activities is not an easily answered question. Understanding how counties currently use realignment public health funding, however, could be useful. The Governor's proposal does not assess counties' use of these resources.
- ***. . . For Remaining Uninsured Population.*** While the Governor's proposal to expand Medi-Cal coverage would reduce the state's number of remaining uninsured, around one million undocumented adults would remain without coverage. Although counties are not required to provide health care services to undocumented immigrants, many do. The Governor's proposal would reduce the amount of realignment funding available to provide health care services to this uninsured population going forward. Should the Legislature wish to continue to dedicate realignment funding to counties to provide health care services for low-income, uninsured residents (who are primarily undocumented adults), it is unclear whether the amount of realignment funding for health under the Governor's proposal would be sufficient.

In light of this uncertainty, we suggest the Legislature direct the administration to work with counties to determine if revenues and responsibilities align for health and mental health. At minimum, this would require determining what specific services should be paid by the health and mental health revenues and collecting data from counties on the cost of those services.

SUMMARY OF CONCLUSIONS

Governor Proposes Reasonable Approach for Bringing 1991 Realignment Into Financial Balance. Our office and the administration agree that 1991 realignment today no longer meets many of the core principles of a successful state-county fiscal partnership. We find that the *2019-20 Governor's Budge*t proposes a reasonable approach for bringing 1991 realignment into financial balance. In particular, the proposed rebasing of the IHSS county MOE and lower annual adjustment factor make significant progress to align counties' costs with their realignment revenues. A trade-off of the significant reduction in counties' costs, however, is increased state costs. While the state is better positioned than counties to address growing costs in IHSS given it has more control over policy decisions that drive program costs the Legislature may want to begin to consider how to address the needs of the state's growing elderly population.

Recommend Other Improvements. There are additional steps we recommend the Legislature take to strengthen the 1991 realignment structure and improve state oversight of realigned programs. Figure 4 summarizes those recommendations.

Figure 4

Summary of LAO Recommendations

LAO Recommendations
• While the higher state share of cost for IHSS proposed by the Governor is appropriate, the state's ability to control increasing cost pressures associated with IHSS is limited. We recommend the Legislature plan for the impact of a growing senior population on the state budget.
• Whether realignment revenues will be sufficient to cover counties' costs long term remains unclear. We recommend the Legislature monitor—through the annual budget process—that realignment revenues generally cover program costs over time.
• In some cases, the Governor's proposal would redirect revenue currently supporting counties' public health activities. We recommend the Legislature consider the impact on public health funding when evaluating the Governor's proposal.
• Governor proposes to limit CMSP's revenue and various policies have reduced the number of low-income state residents without health care coverage, which CMSPs serve. We recommend the Legislature consider the continued viability and purpose of CMSP going forward.
• Remains unclear whether health and mental health realignment funding is aligned with counties' current responsibilities. We recommend the Legislature assess the alignment of funding for county health and mental health with county responsibilities.

IHSS = In-Home Supportive Services and CMSP = County Medical Services Program.

LAO PUBLICATIONS

This report was prepared by Lourdes Morales and Jackie Barocio, with assistance from Ben Johnson, Ryan Woolsey, Ryan Millendez, and Sonja Petek, and reviewed by Ginni Bella Navarre and Carolyn Chu. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

To request publications call (916) 445-4656. This report and others, as well as an e-mail subscription service, are available on the LAO's website at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.