Behavioral Health Services Act Revenue Stability Workgroup Report

May 2025

CALIFORNIA DEPARTMENT OF
HEALTH CARE SERVICES

TABLE OF CONTENTS

Background and Purpose

The Mental Health Services Act (MHSA), passed as Proposition 63 in 2004, and became effective January 1, 2005, established the Mental Health Services Fund (MHSF). Revenue generated from a one percent tax on personal income in excess of $1 million is deposited into the MHSF. In March 2024, California voters passed Proposition 1 to implement the statutory changes in Senate Bill 326 (Eggman, Chapter 790, Statutes of 2023), renaming the MHSA to the Behavioral Health Services Act (BHSA), and modernizing and reforming the public behavioral health care system.

The Department of Health Care Services (DHCS) is enacting changes resulting from Proposition 1 through the Behavioral Health Transformation project. Pursuant to Welfare and Institutions Code section 5892.3, subdivision (a), the BHSA Revenue Stability Workgroup was created to assess year-over-year fluctuations in tax revenues generated by the BHSA, in recognition of the need for a reliable strategy for short- and long-term fiscal stability.

The Workgroup was required to develop and recommend solutions to reduce BHSA revenue volatility and to propose appropriate prudent reserve levels to support the sustainability of county programs and services.[1] The Workgroup was required to review and analyze current and historical revenues generated pursuant to the MHSA and the BHSA.[2] Lastly, the Workgroup was required to review and analyze current and historical prudent reserve levels to develop the recommendations.

Statute requires the DHCS and the California Health and Human Services Agency (CalHHS) to submit a report with recommendations to the Legislature, and the Governor's Office, on or before June 30, 2025[3], on how to reduce BHSA revenue volatility and to propose appropriate local prudent reserve levels to support the sustainability of county programs and services. This report serves as fulfillment of the requirements described in statute. Components of the recommended proposal will require changes to current statute.

[1] Welfare and Institutions Code (W&I Code) § 5892.3, subdivision (b)
[2] W&I Code § 5892.3, subdivision (d)
[3] W&I Code § 5892.3, subdivision (e)

Recommendations

The recommended proposal is designed to reduce the variance of county Behavioral Health Services Funds (BHSF). The State Controller's Office will continue to follow the current process to distribute BHSA local assistance funds to counties monthly. The goal is to balance local assistance revenue allocation and program stability, helping counties effectively plan and provide critical behavioral health services during revenue downturns. This proposal meets these goals.

The recommended proposal would establish a minimum expenditure level that counties will use to plan for program expenditures and implement BHSF services. The goal is to provide more stability by smoothing out the fluctuations that could occur in annual BHSA local assistance revenue. Counties would be required to use the minimum expenditure level to develop their Integrated Plan for Behavioral Health Services and Outcomes (Integrated Plan), which describes how counties plan to use their BHSA funds over a three-year period and plan to spend at least the minimum expenditure level each fiscal year. To help ensure that county BHSA funding is available and being used for services, this recommended proposal includes reducing the current maximum level of prudent reserves that counties could maintain. Additionally, it allows for increased flexibility for counties to access local prudent reserves during years of economic downturns.

More specifically, the recommended proposal is as follows:

1. The annual minimum expenditure level will be calculated for each county for local BHSF based on historical county BHSA revenue distribution data and a three-year trailing weighted average.

   <u>Step 1:</u> Implement a weighted three-year trailing average (60%, 25%, and 15%), giving the highest weight to the most recent year revenue distribution available (two years prior) for calculating county minimum expenditure levels.

   Example (to determine minimum expenditure level for FY 25-26):
   2023-24 Distribution Data =$130M revenue X 60% weight =$78M
   2022-23 Distribution Data = $110M revenue X 25% weight = $27.5M
   2021-22 Distribution Data = $100M revenue X 15% weight = $15M
   Trailing Average Calculation = ($78M+$27.5M+$15M = **$120.5M)**

Step 2: Increase the trailing average calculation by an annual inflationary adjustment of four percent per year to cover the two-year time lag between the most recent year for which actual revenue totals are available and the year that the county is developing their Integrated Plan or Annual Update. This results in an overall inflationary adjustment of eight percent for a two-year period. This calculation will provide the minimum expenditure level for the first, second, and third year in the Integrated Plan cycle.

Example:

$120.5M Trailing Average Calculation

X 8% *Inflationary Factor*

$130.1M Integrated Plan Minimum Expenditure Level (Year 1, Year 2 and Year 3)

2. Counties would be required to spend at least the minimum expenditure level annually on BHSA programs, consistent with the local Integrated Plan or Annual Update.
3. Counties would receive updated minimum expenditure levels annually. If the county's updated minimum expenditure level is more than 10 percent higher or lower than the prior year's minimum expenditure level, counties would be required to complete a budget update in the Integrated Plan or Annual Update.
4. Counties may continue to establish a local prudent reserve up to a maximum of 10 percent for medium and large counties (defined as having a population of more than 200,000) and 15 percent for small counties (defined as having a population of 200,000 or less) of the average of the total BHSA and/or MHSA funds distributed to the county in the preceding five years.
5. Counties would be required to implement a one-time decrease of their prudent reserve for the Fiscal Years 2026-2029 Integrated Plan to adhere to the new maximum prudent reserve levels. Counties would have local discretion on how to spend the excess prudent reserve funds for the one-time decrease and be allowed to exclude the excess prudent reserve funds from prescribed BHSA component funding allocation percentages (30% Housing Interventions 35% Full-Service Partnership and 30% Behavioral Health Services and Supports).
6. If the local prudent reserve is accessed due to a downturn in the economy, counties would be allowed to use prudent reserve funds at local discretion for services or programs identified in an approved Integrated Plan or annual update, and in accordance with the BHSA components allocation requirements.

7. Establish a budgetary revision process that will allow counties to reduce the minimum expenditure level amounts if forecasted local assistance revenue is less than the calculated minimum expenditure level.

Appendix Table 1 depicts how the proposal could affect local prudent reserve and county unspent fund balances statewide for FY 2023-24 through FY 2029-30. The following sections provide additional discussion, including the rationale behind each of the proposal's major provisions.

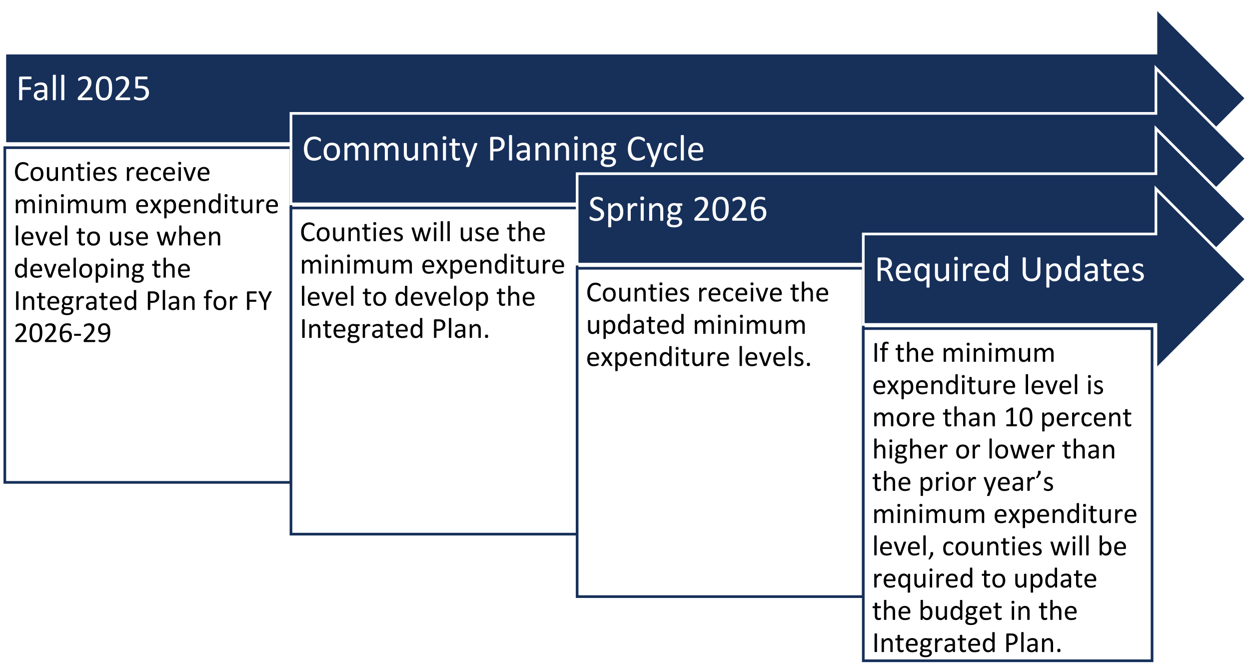
Minimum Expenditure Level

The proposal calculates a minimum expenditure level that accounts for historical BHSA distribution revenue trends and year-over-year fluctuations to provide counties with a more stable estimate of a minimum spending requirement that counties must meet. The State Controller's Office will continue to follow the normal process to distribute BHSA local assistance funds to counties monthly. As noted above, a minimum expenditure level will be calculated using historical BHSA revenue distribution data with a three-year weighted trailing average. A three-year weighted trailing average will, in most years, allow counties to respond quickly to more recent trends in BHSA revenue distributions, while providing stability by including previous years' revenue distribution to smooth out the volatility. To adjust for a two-year lag in revenue distribution data and the fact that BHSF tend to grow significantly over time, the weighted average will then be increased by a 4 percent inflationary adjustment per year (8 percent total). This calculation will provide the minimum expenditure level for the first, second, and third year in the Integrated Plan cycle. Counties would receive updated minimum expenditure levels annually; counties would be required to spend at least the minimum expenditure level each fiscal year.

To account for instances in which BHSA local assistance revenue distributions are forecasted to be significantly less than the minimum expenditure level, counties may reduce their minimum expenditure level down to align with forecasted local assistance revenues during that fiscal year, through a budgetary revision process. Department of Finance (DOF) local assistance revenue projections will be used to determine if the forecasted local assistance revenue will be less than the calculated minimum expenditure level. If the amount of the forecasted local assistance revenue is more than 10 percent below the minimum expenditure level, counties would receive revised minimum expenditure levels that reflect the decrease in projected local assistance revenues. Counties will have the option to spend to the revised minimum expenditure level or continue to spend the original minimum expenditure level. Counties may also choose to transfer funds from their prudent reserve to fill any revenue gaps during a low revenue year. Counties will be required to complete a budget update in the Integrated Plan or Annual Update, only if the county's updated minimum expenditure level is more than 10 percent higher or lower than the prior year's minimum expenditure level.

The budgetary revision estimates will be provided at two different points during the county Integrated Plan or Annual Update planning cycle. The first will be when counties are provided with initial minimum expenditure levels in the Fall, preceding the beginning of the county budget year in July. The projections will be based on the Department of Finance BHSA local assistance revenue estimates consistent with its multi-year budget forecast contained in the Budget Act for the current year. The second will be in May and will be based on the DOF May Revision revenue forecast for the upcoming budget year. As an example, the first projection for the 2026-27 budget year will be provided to counties in the Fall of 2024 and be based on the multi-year budget forecast contained in the Budget Act for 2024-25. The second projection will be made following the release of the May Revision revenue estimate for the 2025-26 budget year.

Table 1: Timeline for Notifying Counties of Minimum Expenditure Level



Length of Funding Cycle

The minimum expenditure level each fiscal year will be calculated and provided to counties following receipt of new BHSA revenue distribution data. If the new minimum expenditure level is less than 10 percent higher or lower from the prior year minimum expenditure level, counties may continue to fund programs in accordance with the most current Integrated Plan or Annual Update. If the minimum expenditure level is greater than 10 percent, counties will be required to update their Integrated Plan or Annual Update, including the budget. The 10 percent threshold provides counties with funding stability during most years but also allows them to make adjustments to the Integrated Plan or Annual Update when significant revenue changes occur. Counties will still be required to submit Annual Updates per Welfare and Institutions Code section 5963.02.

Local Prudent Reserve Requirements

The proposal would continue to allow counties to establish and utilize a local prudent reserve to stabilize the minimum expenditure level during an economic downturn and decrease in BHSA revenue distribution. Counties would be able to access a local prudent reserve quickly to adjust during an economic downturn. The proposal considered appropriate maximum limits on the amount of prudent reserve funding to avoid counties building excess reserves, rather than allocating the funding to BHSA services. A local prudent reserve of up to a maximum of 10 percent for large and medium counties and a maximum of 15 percent for small counties of the average of the total BHSA funds distributed to the county in the preceding five years is recommended. Under BHSA, prior to 2026, counties are allowed to fund their local prudent reserve up to twenty percent for large counties and twenty-five percent for small counties. Under MHSA, counties have built significant local prudent reserves but have not accessed the reserves in prior years when there was an economic downturn. As reported in the most recent Mental Health Services Act Expenditure Report 2024 Budget Act, as of FY 2022-23, there are 23 counties that are under the maximum prudent reserve funding and one county that does not have any funds in their local prudent reserve. Many counties also have significant local unspent MHSA fund balances. While it is understood that some of the unspent MHSA funds may be targeted for future capital outlay or other purposes, the amount of unspent MHSA fund balances has nevertheless risen sharply over the past decade – at times approaching a year's worth of spending. These local unspent fund balances can be used to help maintain services during a temporary revenue distribution downturn and could be utilized during an economic downturn. During an economic downturn, counties would be able to access their local prudent reserve at their discretion and would be allowed to utilize the funds to support BHSA programs, consistent with statutory requirements.

One-time Transfer of Prudent Reserve Excess Funds

Counties with local prudent reserve funds above the 10 or 15 percent maximum, as of June 2026, will be required to do a one-time transfer of excess funds to the BHSA components to support BHSA programs and services during FY 2026-27. Counties will have the flexibility to determine which component the funds may be transferred into. Additionally, any funds transferred will be excluded from the prescribed BHSA funding allocation percentages for this one-time transfer. This flexibility supports counties' ability to provide services under BHSA components during the transition from MHSA to BHSA.

Accountability

Counties will be required to report planned BHSA expenditures and prudent reserve data in the Integrated Plan and report actual BHSA expenditures, including prudent reserve usage, in the Behavioral Health Outcomes, Accountability, and Transparency Report. This requirement ensures transparency in how counties utilize local BHSA funds and funds drawn down from their local prudent reserve. Counties must engage with local stakeholders to develop each element of their Integrated Plan. Counties are required to demonstrate a partnership with constituents and stakeholders throughout the process that includes meaningful stakeholder involvement on mental health and substance use disorder policy, program planning and implementation, monitoring, workforce, quality improvement, evaluation, health equity, and budget allocations (including prudent reserves).

Summary of Workgroup Process

DHCS and CalHHS convened the Workgroup and held three meetings between July and October 2024. As required in statute, the Workgroup included representatives from key organizations including the Behavioral Health Services Oversight and Accountability Commission (BHSOAC), Legislative Analyst's Office (LAO), County Behavioral Health

Directors Association of California (CBHDA), and California State Association of Counties (CSAC), including urban and rural county representatives.[4]

The Workgroup outlined the following key elements for consideration in a proposal:

1. Establishing a base funding level;
2. Establishing the length of time for each base funding cycle;
3. Establishing a reserve mechanism (e.g., State Revenue Stabilization Account or maintaining a Local Prudent Reserve);
4. Local prudent reserve requirements

[4] W&I Code § 5892.3, subdivision (c)(2)

Appendix

Table 1. Modeling of Minimum Expenditure Level, Statewide Prudent Reserve, and Unspent Fund Balances FY 2023-24 through FY 2029-30 (For Illustrative Purposes Only)

Fiscal Year	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Annual Distributions[1]	$3,711,951,464	$4,046,027,096	$2,710,838,154	$4,066,257,231	$4,676,195,816	$5,143,815,398	$5,606,758,784
Percent Change[2]	72.6%	9.0%	-33.0%	50.0%	15.0%	10.0%	9.0%
Minimum Expenditure Level[3]	$3,110,656,202	$2,702,599,244.57	$3,364,485,748	$3,978,327,430	$4,137,460,527	$4,302,958,949	$4,573,986,374
Percent Change[4]	N/A	-13.1%	24.5%	18.2%	-13.1%	24.5%	6.3%
BHSA Annual Distributions + Spending of Prior Year County Unspent Funds[5]	$3,617,349,690	$3,264,802,228	$4,050,930,040	$4,664,771,723	$3,891,633,422	$4,627,605,571	$5,161,817,424
Percent Change[6]	N/A	-9.7%	24.1%	15.2%	-16.6%	18.9%	11.5%
Statewide Local Prudent Reserve[7]	$240,616,190	$274,328,842	$0.00	$87,929,800	$333,712,574	$384,225,395	$412,862,673
County Unspent Funds Balance[8]	$2,708,340,014	$3,455,852,230	$2,390,089,186	$1,703,644,893	$2,242,424,513	$2,708,121,519	$3,124,425,599

1 This is the annual MHSA or BHSA revenue distributed to counties monthly by the State Controller's Office.
2 Percent change in annual BHSA distributions from the prior year. This is calculated by taking (Current Year – Previous Year)/Previous Year.
3 This reflects the minimum expenditure level counties will be required to spend, not the total BHSA allocation that is to be distributed monthly to counties for BHSA services. This minimum expenditure level amount includes the inflationary adjustment. Counties will develop their Integrated Plan (IP) based on their minimum expenditure level. The minimum expenditure level is calculated by taking the weighted average of the last 3 years, with the most recent year starting two years prior. After taking the weighted average, a 4% inflationary rate is applied twice to bring it up to the current year. The formula is (Y1*0.60 + Y2*0.25 + Y3*0.15) * (1.04)^2.
4 Percent change in minimum expenditure level from prior year. This is calculated by taking the (Current Year – Previous Year)/Previous Year.
5 This reflects the annual BHSA distribution for BHSA services and assumes prior year unspent BHSA funds are spent on BHSA services.
6 Percent change in minimum expenditure level from prior year with excess funds spent on BHSA services. This is calculated by (Current Year – Previous Year)/Previous Year.
7 Actual balance in prudent reserves statewide as reflected in the MHSA Expenditure Report 2024 Budget Act.
8 Amount of unspent funds available statewide as of FY 2022-23 County Annual Revenue and Expenditure Report data.

The data in the table above depicts the statewide prudent reserve and county unspent funds balance based on the weighted three-year trailing average (60%, 25%, 15%), an annual inflation adjustment of 4%. The data assumes all counties have a 10% maximum prudent reserve, any excess reserves are spent equally over the next three years of the funding cycle, and counties fund at the three-year trailing average in all years to demonstrate the effect on prudent reserves and unspent fund balances without utilizing the budgetary revision process. This data is hypothetical and used for explanatory purposes only.