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May 13, 2025

Honorable Scott Wiener, Chair
Joint Legislative Budget Committee
1020 N Street, Room 553
Sacramento, CA 95814

Honorable Christopher Cabaldon, Chair
Subcommittee No. 4
Senate Budget and Fiscal Review Committee
1020 N Street, Room 502
Sacramento, CA 95814

Honorable Sharon Quirk-Silva, Chair
Subcommittee No. 5
Assembly Budget Committee
1021 O Street, Suite 4210
Sacramento, CA 95814

SUBJECT: ANNUAL STATE DATA CENTER SERVICES RATE METHODOLOGY REASSESSMENT

Dear Senator Wiener:

Government Code (GC) 11540.5 requires the California Department of Technology (CDT), in consultation with the Department of Finance (Finance), to reassess the formal rate methodology and relevant policies and procedures for state data center services. To complete the rate assessment, GC 11540.5 requires CDT and Finance to do the following:

1. Develop a rate structure that would allow a state entity or other customer of a state data center to compare services offered by state data centers with comparable services offered by major commercial vendors, including, but not limited to, features, levels of service, rates, and service options for all offered services;
2. Determine and designate which state data center services are either cost-inefficient or mandatory;
3. Evaluate the potential elimination of both cost-inefficient state data center services and nonmandatory state data center services provided;
4. Recommend revising policies, procedures, and strategies for providing state data center services, including the following:
    i. Create centralized contracts for shared information technology services to replace state data center services;

ii. Require state entities to use specific state data center services needed to maintain a certain level of service for critical programs; and,
iii. Instating term agreements for state data center services to improve revenue and expenditure forecasting.

GC 11540.5(f) requires CDT to submit a written report to relevant budget subcommittees of both houses and to the Joint Legislative Budget Committee on progress toward the State Data Center (SDC) rate reassessment requirements commencing April 1, 2023, and every twelve months thereafter until August 1, 2025. The reassessment will recommend changes to current policies, procedures, and strategies related to all the following outcome metrics:

(1) The total number of services offered by state data centers;
(2) The total number of services identified for elimination;
(3) An explanation and timeline for the elimination of inefficient or non-mandatory services;
(4) The amount and percentage change in rates, if any;
(5) The explanation for the change in rates, if any;
(6) The estimated difference in rates by service between the state data centers and significant commercial vendors;
(7) An explanation for the difference in service rates;
(8) The forecasted change in service subscriptions over the current fiscal year and the next two fiscal years; and,
(9) The forecasted change in state data center revenues and expenditures over the current fiscal year and the next two fiscal years based on the change in subscriptions.

Sustaining a Future-Focused Data Center Financial Model

Over the past three years, CDT has worked continuously with Finance and our customers to establish a sustainable financial model and improvements to our service offerings that optimize value for our customers.

The CDT's State Data Center (SDC) is one of the state's most vital technology assets delivering secure, equitable, and reliable technology services to all Californians. The SDC also provides continuous security and operational capabilities designed to protect California's systems, resident data, and ensure the state's critical services remain available. The SDC continues to drive technological innovation in areas such as artificial intelligence capabilities, Generative Artificial Intelligence (GenAI) technical sandboxes, digital identification services, and managed cloud services. CDT also regularly evaluates all service offerings to ensure they remain relevant and effective at meeting the state's evolving needs. CDT is a unique organization that is both an information technology (IT) service provider, a policy maker, and worldwide leader in IT innovation.

When comparing SDC and private sector rates, SDC rates can seem higher than basic private sector prices because private sector prices do not reflect the total investment that a customer must make to receive the same level of value the SDC provides. Specifically, the SDC's managed service rates always include 24x7x365 security, engineering, and technical support offerings. These services are typically considered premium add-ons by private sector IT service providers. As such, they pay a higher cost when departments add these critical and sometimes required (by policy) services to their private sector packages. Additionally, the SDC provides fully trained, unionized staff with expertise in various technical and operational areas tailored to meet the state's needs consistent with GC 19130.

The SDC has consistently demonstrated the ability to provide services and support that exceeds the standard private sector model, especially during emergencies. For example, in July 2024, California was impacted by a global service disruption caused by a major technology vendor. Even as the vendor actively tried to resolve the problem, many technology platforms and services serving the California government and our communities needed immediate hands-on help. Many state and local organizations turned to CDT and the SDC for assistance during this difficult time. The SDC was able to achieve full recovery within 48 hours of this external incident, whereas state entities maintaining a self-managed environment sometimes took more than one week to fully recover. Other States affected by this same incident even lost access to critical services including emergency response capabilities. CDT's quick and coordinated response is typically not reflected in a service cost analysis, but the value to the state is immeasurable.

CDT was established as a cost-recovery organization and provides a wide variety of other statewide services and programs that benefit the state, including information security, enterprise architecture, project oversight, technology procurement, digital services, and professional development. CDT's rates are structured in a way that also indirectly supports many of these programs. Therefore, SDC customers must be charged for programs and services that may not directly relate to delivering the SDC services they receive. More specifically, on an average monthly invoice, only 50 percent of a customer's total bill represents CDT's costs for directly providing IT services whereas the remaining 50 percent often comprises indirect and administrative overhead costs related to CDT's other statewide programs and services. Knowing that many of CDT's statewide programs and services lack a billable customer, CDT continues to work with Finance to determine the best way to fund these services and programs that reduce the impact on SDC customer rates.

Although CDT has successfully identified opportunities to streamline its production costs, increasing operating expenses and growing demand for non-SDC programs and

statewide services have led to under-recovery of SDC service costs, requiring rate increases that pressures our pricing competitiveness. Nevertheless, the SDC must maintain legally obligated or critical services even when full cost recovery is not possible. Therefore, a long-term solution and future-facing financial model are needed to address these additional indirect non-SDC costs.

The Future of the State Data Center

CDT's future model evolves from a primarily on-premises hosted model to a more responsive and flexible environment. This environment includes increased usage of shared infrastructure, managed hosting environments, and statewide contracts well designed for the state's current and future technology needs. CDT's approach is also designed to adapt to emerging tools and technologies such as GenAI, Digital ID, and enhanced digital services.

CDT will also continue to support a wide variety of complex on-premises and cloud hosted solutions tailored to our customers' specific business needs. As service offerings expand to include more passthrough models, our funding structure must evolve to allow CDT to support these popular services.

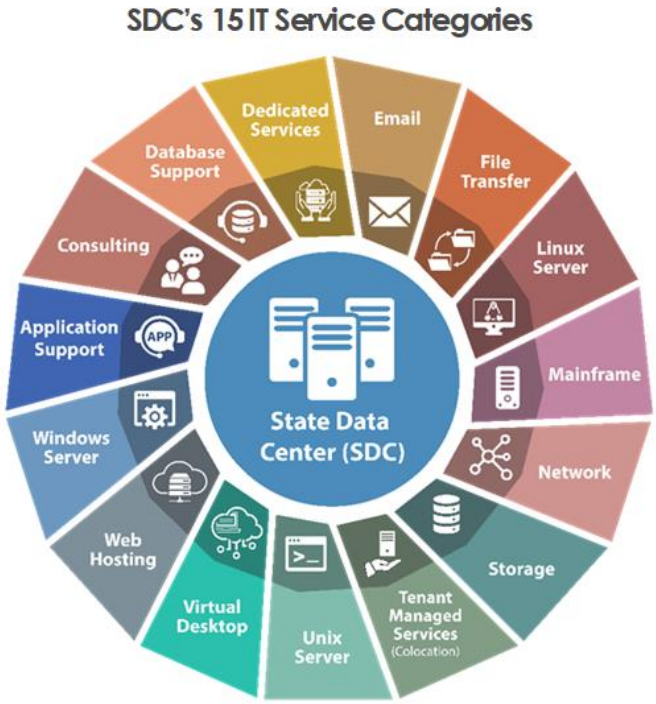
CDT will continuously evaluate the state's technological needs and regularly enhance its service offerings to meet them. CDT will also continue to work with Finance, the Administration, and the Legislature to stabilize CDT's funding model and minimize the effect of future rate increases on state technology operations by continuing to achieve economies of scale and reducing the number of redundant technology programs, contracts, and services that exist across the state. To avoid slowing the adoption of popular services due to limited budget authority, CDT will also improve its ability to project demand and work with Finance to increase our customer capacity.

To help the SDC achieve this long-term vision, Finance's Research and Analysis Unit (RAU) and CDT have initiated a Mission-Based Review (MBR) to assess and address CDT's rate development process and funding appropriateness issues. CDT and the RAU are collaboratively working to determine the combination of funding sources that are most appropriate to support CDT's ongoing statutory mission, programs, and services in the hope of building an equitable long-term funding model that does not burden the SDC customer with supporting statewide efforts and initiatives. CDT aims to use the RAU's analysis and recommendations to inform Finance's review of CDT's Fiscal Year (FY) 2025/26 rate package and develop any associated proposals for the FY 2025/26.

Reviewing and Optimizing State Data Center Service Offerings

CDT continues to explore ways to make our services more efficient and accessible by taking advantage of uniform architecture and sustainable integration with third-party

solutions to improve our service offerings. Although the existing 15 IT service categories provided by the SDC have remained, we continue to balance service offerings and configurations that ensure continuity for critical services, best respond to customer demand, and best align to technology goals established by CDT, the Administration, and the Legislature. The core services provided by the SDC include Application Support, Consulting, Database Support, Dedicated Services, Email, File Transfer, Linux Server, Mainframe, Network, Storage, Tenant Managed Services, Unix Server, Virtual Desktop, Web Hosting, and Windows Server. The SDC is constantly improving the efficiency and scope of our offerings and is exploring the feasibility of new GenAI sandboxes and production services to support the Governor's Executive Order N-12-23 (GenAI EO) from September of 2023.



State Data Center Service Evaluation

Evolving Services to Meet Innovative Technology Demands

CDT has been instrumental as a key leader, driver, and contributor in implementing the Governor's GenAI EO to study the development, use, and risks of GenAI technology.

CDT's expertise in providing these novel development and test environments for evaluating GenAI proofs of concepts (POCs) shows the flexibility and speed of a hybrid environment. The CDT provided multiple state entities with safe, secure, stable, and scalable "sandboxes" to test these technologies besting the original estimated timeframes. The POC efforts have allowed CDT to build strong collaborations with

agencies to better understand their technical needs. This power contained in GenAI technology emphasizes the significance of adhering to security policies and technical standards. This practical experience will help CDT continue its world-leading efforts in testing, deploying, and delivering innovative GenAI technologies to California.

Landmark Senate Bill (SB) 362, 2023 seeks to restore California residents' control of their personal identifiable information (PII) by facilitating complete removal of their PII held by data brokers. The California Privacy Protection Agency (CPPA) chose to work with the SDC for the design, development, and support of this unprecedented solution for California residents. The SDC's technical expertise coupled with safe, secure, and stable state-managed infrastructure positioned CDT to be agile and responsive. The resulting solution will continue to adapt to emerging needs and rapidly changing technology requirements.

Services Identified for Elimination and Timelines

In October 2022, CDT began evaluating the rates charged to SDC customers compared to services offered by private vendors to provide a cost analysis of the SDC's services. Challenges emerged when comparing private sector services to public sector services early in the process. Variable pricing models from commercial providers offer an array of cost models that often include short-term incentives and discounts that obscure ongoing costs and dissimilar economies of scale, complicating attempts to compare services for state government entities against a global market. For example, a commercial cloud provider charges an "a la carte" price for an individual component, which may fluctuate wildly throughout the year.

In contrast, the SDC provides consistent and predictable rates based on the volume of billable units used or consumed. CDT rates are based on the cost of a fully packaged service, comprised of direct, indirect, and administrative overhead costs, mandatory and/or oversight services (i.e., pro-rata charges), and statewide services. These packaged rates provide some insulation to fluctuation, even though the SDC is subject to external inflationary and economic factors.

While the SDC is minimizing disruption to operating expenses, the technology industry is consolidating, and companies are using monopoly power to control prices. In late 2023, a large company acquired a major virtualized infrastructure provider, which led to significantly higher costs and operational uncertainty for state customers. Using the bulk buying leverage of the state, the SDC was able to negotiate pricing that helped smaller departments maintain operations while continuing to help them explore alternative options.

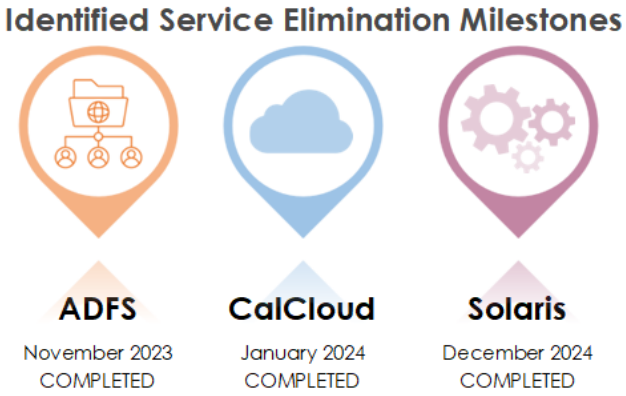
CDT will continue to evaluate services and look for opportunities to eliminate underperforming services and expand viable services when appropriate. In addition,

CDT has implemented a purchasing review process that includes a committee comprised of executive staff within the SDC. This is part of an internal control system that looks for opportunities to mitigate risks associated with inefficient use of government funds. This committee scrutinizes every new purchase, including hardware, software, and licensing costs, and examines contract renewals containing cost increases.

In 2022, CDT worked with Gartner (a globally recognized IT industry consultant) to initiate a report that benchmarked the SDC against 14 peer entities. CDT was able to compare the SDC's rates to recover direct costs against the benchmarked entities rates and analyzed the results to determine that CalCloud, Linux Server, and Windows Server were cost inefficient. CDT then identified Active Directory Federation Services (ADFS), CalCloud, and Solaris as candidates for elimination; and monitored the financial performance of Linux and Windows servers. Using the data from the Gartner report, the SDC sunset three configurations to eliminate inefficient services, improve the SDC's rate structure by reducing the number of rates, and avoid future cost increases.

CDT is pleased to report that all three service configuration eliminations have been completed.

- **Active Directory Federation Services**
  This service was successfully replaced in November 2023 with no interruptions to service delivery.
- **CalCloud**
  By the first quarter of 2024, existing customers successfully migrated to a managed cloud platform which delivered immediate increases in cost efficiency. There were no service outages while transitioning customers. This benefited the SDC's operating model by consolidating services to a single platform and reducing licensing costs rather than supporting multiple cloud solutions.
- **Solaris**
  All SDC Solaris customers migrated off Solaris managed services as of December 2024. The SDC has decommissioned and removed the physical equipment that supported this service.



Challenges Associated with Eliminating Services

The age or financial performance of an IT system does not always define its reliability, utility, or criticality. CDT's continual assessment of its services accounts for the varied factors associated with the continuation of support for a financially underperforming service which includes the following challenges associated with eliminating or migrating services from their existing platforms:

- **Risk of disruption**: Migrating critical systems can pose a risk of disrupting essential services, thereby negatively affecting vulnerable populations, such as low-income families and other individuals reliant on these programs.
- **System complexity**: Critical systems are complex and have many interconnected components, making it difficult to migrate or eliminate them without disrupting other critical services. These systems often involve stakeholders, data exchanges, and integrations with other systems which further complicates the migration process.
- **Inefficient or wasteful spending**: Upgrading or migrating to new platforms can be expensive, where the cost of migration outweighs the benefits of moving away from an existing, stable, and reliable infrastructure.
- **Time-consuming**: The migration process can be laborious, requiring significant internal and external workforce resources, and can require multiple outyears to complete.
- **Stability and reliability**: Although potentially perceived as outdated, many existing platforms have been tested and proven to be some of the state's most stable and reliable technologies. Change may introduce new risks, uncertainties, and subsequent unplanned costs.

As an example, the Department of Public Health's Women, Infants and Children (WIC) program is hosted on SDC's IBM based Linux system with an Oracle database. The

platforms are stable and high-performing to meet the program's large-scale payment delivery requirements. None of the current system components are obsolete or unsupported by the manufacturer. Therefore, the expense of changing the new, unproven system must be weighed against the cost to maintain the stable, existing system. The WIC program provides vital nutrition assistance to low-income families, and any disruption to this service could have severe consequences for the health and well-being of these vulnerable populations. The state must consider the potential ramifications and risks to women, infant, and children if moving a critical system to a more unreliable, untested platform causes more issues.

Additionally, the Employment Development Department's (EDD) system for unemployment benefits is a lifeline for individuals who have lost their jobs, providing critical financial assistance during times of need. Disrupting this service could have devastating consequences, including delayed or lost payments, which could exacerbate financial hardship, increase poverty, and worsen overall well-being. The importance and consequence of these programs must be considered to accurately evaluate the future of an IT platform. As the current system is stable, investing to keep it current has a lower cost than the design, build, and migration to a new tool.

In another example, a large department with a significant investment in the data center requested approximately $350 million to replace the mainframe system currently housed at the SDC. The initial replacement cost of $350 million is equivalent to 12 years of utilization costs in the current SDC system. This replacement service is redundant to the SDC's existing infrastructure and cloud services, which are notably a fraction of the replacement cost. CDT recognizes that any disruption to these services could compromise public safety and convenience. Therefore, the stability of the SDC mainframe is an organizational advantage over the risks and expense faced during complex whole system migrations. Reinvesting in mainframe is a customary and ongoing choice for institutions, such as banks and insurance companies, performing high volume transactions. Industry standard practice is to pair modern web interfaces for web and mobile interactions with mainframe systems for the high speed "backend" transactions for which mainframe was designed. This hybrid approach facilitates more cost-effective modernization and implementation of current and cost-saving technology strategies, while improving the end user experience.

Recent Gartner research in 2024 indicates that the global trend is increasing investments in data centers by six percent over previous years and decreasing cloud services by a similar percentage. The reinvestment is to create hybrid infrastructure services combining the best features of a localized data center with the benefits of cloud computing. Hybrid configurations have proven to drive significant advantages in data security, application development flexibility, service quality (uptime), service

specialization, lower energy consumption, set enforceable spending limits, and avoiding vendor lock-in. This trend validates the administration and legislation's ongoing decision to invest in the state's data center and coincides with CDT's strategy to leverage the investment in the SDC to bring specific high-volume services into the data center at a lower cost to the state than possible in public cloud offerings.

This trend's critical business driver is GenAI, which uses massive amounts of data and computing resources to deliver value. According to research from Accenture (a multinational IT industry consultant), high-volume data storage and egress are best managed within the SDC for unmatched security, tighter financial controls, and derived business value. CDT leads the way as the first state in the world to use its hybrid model, California Managed Cloud (CAMC), during the GenAI EO's technical sandbox efforts. Continued investment in the SDC to build these hybrid services will be crucial to the state's ability to scale up GenAI adoption and realize value.

In summary, these examples demonstrate that the best solution may not always be to sunset a service simply because it is under-recovering or to migrate away solely for the sake of modernization.

Critical Services

Per GC 11545 and 11546, CDT is mandated to provide policy and oversight of technology strategy, projects, procurement, information security, workforce development, and general-purpose technology services to state entities in the executive branch. Additionally, the State Chief Information Officer (CIO) advises the Governor on the strategic management and direction of the state's technology resources and is given broad discretion to develop programs, policies, and services necessary to do so.

Therefore, departments and agencies in the executive branch must consider using CDT's programs and services before seeking alternative options. CDT's services and programs are designed and implemented to most of the state's technological needs, drive innovation and modernization, and address inefficiencies and risks. CDT's programs and services also help minimize redundant costs and centralize critical technology investments resulting in significant financial savings for the state while improving security and reliability.

The specific programs and services provided by CDT will vary based on the state's changing technology needs and will adapt to include emerging technologies as the state seeks to adopt them. CDT will also continue to evaluate cost-inefficient services, changing customer needs, and the viability of aging technologies to ensure the state is investing in the most robust technologies designed to meet the needs of the state and

its residents. This approach allows innovation to flourish, while helping scale new or enhanced features quickly and reducing technical debt to benefit the entire state.

For example, CDT recently improved its Software-Defined Wide Area Network (SD-WAN) service to better meet customers' needs. In February 2025, CDT completed a network upgrade that improved speeds tenfold (from 10 gigabits to 100 gigabit) for all customers. Due to investments like these, departments are choosing to invest in CDT services as they are lower cost than commercial offerings, while being instantly compliant with state requirements.

CDT continues to add new services to meet customer needs. The SDC's cloud and on-premises offerings have improved in both variety and completeness over the past two years. As such, CDT has quickly expanded the scope, scale, and capability of our managed cloud and on-premises offerings while maintaining domain expertise and economies of scale. If a customer requests a service not currently offered by CDT, we will first explore the possibility of adding that service to meet their need. In the rare occasion CDT cannot meet a technical need or requirement, we will work with that state entity to find an alternative solution.

An example of financial savings achieved through CDT's services, AB1637, 2023 mandates that government entities utilizing public-facing websites and/or employee email accounts must use the ".gov" or "ca.gov" suffix. In support of this statewide solution, the SDC collaborated with a vendor to provide the necessary software license at a significant cost reduction. It was discovered that individual departments are contracting these services separately. This incurs significantly higher costs than accessing the service through the SDC's centralized solution.

For just five state entities working to comply with AB 1637, the total cost for this service is approximately $8.8 million and would require 5 - 10 full-time employees. By contrast, the SDC's statewide solution costs an estimated $2.2 million and would require only 2 full-time employees to support this solution statewide including local level government entities. CDT's cost savings represent one fourth of the cost and a fraction of staffing resources compared to individual state entities paying for these services independently.

Additionally, CDT is statutorily mandated to minimize overlap, redundancy, and cost in state information technology operations by promoting the efficient and effective use of information technology. Building off a standardized yet robust infrastructure allows departments to deploy their applications to CDT's secure and reliable services ensuring CDT achieves these important outcomes.

For example, CDT's California Government Enterprise Network (CGEN) provides secure network uniformity and connectivity via the SDC (i.e., Rancho Cordova and Vacaville) throughout the state of California, enabling agencies to rely on CDT to connect their

services to the public, other state agencies, and gain access to the internet or cloud services. This shared resource reduces the state's total cost of ownership by centralizing and sharing resources such as network engineers, telecommunication circuits, networking hardware and software licensing, state data center facilities, and enterprise contracts with the vendor community supporting these products and services.

CDT also monitors budget change requests and the project approval process for efforts that may indicate a potential migration away and divestment from high-value, statewide services provided by CDT. Once identified, CDT consults with these entities to familiarize them with CDT's statewide services that are well-positioned to meet their needs. Very few of these proposals are based on specific technical requirements that CDT cannot meet. Instead, they focus on vendor preference or a desire for greater autonomy despite the formidable staffing and pricing challenges that result when a department chooses to divest from the state's shared infrastructure. CDT actively discourages this practice and seeks to ensure that CDT's programs and services are considered first unless there is a technological limitation that our statewide services cannot meet.

CDT has experienced early success with this approach. For example, as part of a multi-million-dollar renewal in August 2024, EDD decided to keep its eCommerce program within the SDC. Originally desiring to migrate away from CDT, the recent CDT service upgrades were taken into consideration and determined that CDT provided the best value over commercial offerings. A critical consideration to EDD's decision to remain within the SDC was their staff emphasizing the dedicated, personalized service received from CDT staff that they do not receive from other private entities.

In July of 2024, a large department chose to reinvest in new hardware for the mainframe with upgrades to IBM servers. This represents a significant reinvestment in the SDC. Working with the department, CDT reaffirmed the cost effectiveness of reinvesting and modernizing the existing services in the SDC. Coupled with the expertise and services provided by CDT staff, this underscores that moving to an alternative was more cumbersome and expensive. These are a few examples of how this new approach is already benefitting the SDC and departments.

Lastly, the state incurs greater costs and increased security risks when departments develop their own systems and configurations which are often nonstandard, inconsistent with state standards, and in violation of state policies. CDT considers these nonstandard approaches to be Shadow IT, a term used to describe IT-related activities and inconsistent uses of technologies without the knowledge and approval of an IT or security group within state government. Shadow IT operations can have several negative impacts including the following ramifications:

- **Increased Costs**
    - **Wasteful spending:** Unnecessary costs are incurred because of the duplication of IT resources and services already provided by a centralized IT department, especially when departments choose nonstandard or proprietary configurations requiring specialized resources.
    - **Resource limitations:** Nonstandard and proprietary IT configurations and environments are typically overly complex and require specialized staff, training, and knowledge to support which increases the overall costs and risks to the state associated with knowledge loss and aging technology with no clear path for modernization.
    - **Unplanned expenses:** Unforeseen expenses related to maintenance, upgrades, redundant software licenses, services, and security incidents. In most circumstances, the total cost of ownership (TCO) is not fully accounted for.
- **Increased Security Risks**
    - **Data Breaches:** Nonstandard systems and configurations that are unmonitored and unmanaged can be more susceptible to cyberattacks and data breaches, putting sensitive state data at significant risk.
    - **Compliance Issues:** Nonstandard systems and configurations typically do not comply with regulatory requirements, state policy, and industry standards. This can potentially lead to significant legal, security, and financial risks and repercussions.
    - **Prolonged System Outages:** Systems outages resulting from nonstandard IT systems and configurations are often prolonged because the state lacks the specialized knowledge and understanding of how these systems operate and interact with the state's overall technology infrastructure.

CDT must be able to serve the common technology needs of state entities and provide secure technology services for an incredibly diverse set of applications and programs while also mitigating risks. CDT's flexible approach to services coupled with our existing cost-effective centralized IT hosting model provides the best long-term value to the state. When state entities use SDC services, it maximizes the state's investment in critical technology assets, maintains a consistent service experience for residents, and strengthens the state's ability to meet its technology goals and outcomes.

Next Steps for CDT's Services

CDT will continue to leverage the considerable buying power of the state to offer additional shared services and statewide contracts. Creating a shared commodity for

platforms, network, storage, and compute that allows departments, of all sizes, to allocate their valuable resources to servicing their programs rather than redundant and cost inefficient IT functions and services offered at scale by CDT. CDT will continue to be a broker and provider of underlying technologies to deliver instant value and compliance. This common foundation will improve the reliability, simplicity, and reuse of technologies across the state, while lowering costs and removing redundant contracts or purchase orders.

State Date Center Rate Changes and Reassessment

Continuing with our commitment from previous years, CDT's core objectives focus on enhancing cost recovery for our services while ensuring competitive rates and delivering strong value to our statewide customers. We are committed to optimizing our processes, improving efficiency, and making strategic adjustments to ensure our pricing structure remains fair, transparent, and aligned with market standards. At the same time, we aim to preserve the high quality and value that our customers expect, ensuring that our services meet their needs effectively and sustainably.

The following policies and changes are being implemented to achieve these objectives and will remain integral to our ongoing efforts to enhance efficiency and value.

Rate Policies

1. Conduct Annual Rate Changes to ensure ongoing alignment with service delivery and costs.
2. Evaluate CDT's service offerings to sustain a valuable and cost-efficient portfolio.
3. Continue pursuing alternative funding for statewide services not suited for cost recovery.

Rate Changes

In the FY 2024/25 Rate Package, CDT broadly implemented service rate increases to recover expenses for bargained workforce salary increases. Additionally, CDT increased rates in several under-recovering service areas within the SDC to restore aggregate cost recovery for the SDC and CDT.

Within the FY 2025/26 rate package, CDT aims to adjust rates to account for the final phase of the general salary increases and improve cost recovery for under-collecting SDC services.

Moving forward, in the next rate package cycle, CDT endeavors to realign all SDC service rates to recover expenses more effectively with minimal impact on SDC customers. We are optimistic in our pursuit of this goal, thanks to Finance's collaboration in conducting our rate reassessment.

State Data Center Service and Rate Comparison

As outlined on page 3 and in previous years' reports, comparing our services to those of major commercial vendors is inherently flawed and presents misleading conclusions. Such comparisons would unfairly highlight discrepancies in service rates, placing CDT at a disadvantage. This is largely due to the vast differences in market scales and the aforementioned differences in basic consumer and prepackaged California security-compliant service offerings.

Although a direct comparison between the SDC's fully managed services versus private vendor rates is impractical due to the fundamental differences in the scope of service offerings and available cost structures, we recognize the importance of ensuring our rates remain transparent and competitive. Rather than focusing on an immediate rate comparison, CDT will prioritize a detailed review of our service catalog and support models to further streamline offerings and refine cost structures. This foundational work will position the SDC to explore more meaningful benchmarking opportunities in the future, ensuring that any comparisons are based on aligned service levels and accurate cost representation.

State Data Center Service Utilization and Revenue Impacts

Subscription Forecasting

The chart below displays current and forecasted SDC customer subscriptions for IT services over the next two fiscal years. The utilization metrics are based on actual subscriptions and change requests customers submit. Even though the SDC is aware of other modernization projects that may result in additional subscription changes, it is not possible to quantify the impact of modernization projects during this stage of development.

Forecasted SDC Service Subscriptions

SERVICE	METRIC	2024-25	2025-26	2026-27	CHANGE*
Application Support	Application	182	181	181	-0.5%
Colocation (TMS)	Cabinet	441	441	441	0.0%
Consulting	Consulting (Hour)	23	23	23	0.0%
Database Support	Database	289	248	245	-15.2%
Dedicated Services	Instance (Variable)	8,165	8,165	8,165	0.0%
Email	Email	247,376	247,376	247,376	0.0%
File Transfer	Web Services	6,890	6,890	6,890	0.0%
Linux Server	Server	84	14	13	-84.5%
Mainframe	CPU Hour	12,741	12,741	10,591	-16.9%
	Server	36	36	36	0.0%
Network	Connection	1,965	1,965	1,965	0.0%
Storage	Storage (GB)	5,846,060	5,435,628	5,339,355	-8.7%
UNIX Server	Server	220	191	81	-63.2%
Virtual Desktop	User	2,414	2,414	2,414	0.0%
Web Hosting	Web Server	7	7	7	0.0%
Windows Server	Server	211	211	211	0.0%

Figures above represent projected monthly subscriptions
*Change reflects the percent change from FY 2024-25 to FY 2026-27

The chart above forecasts a continued decline in customer utilization for certain services. As discussed in the previous report, several anticipated large system departures (e.g., California Department of Corrections and Rehabilitation, Employment Development Department, Department of Motor Vehicles, State Controller's Office) are driving the bulk of the subscription changes. By the end of FY 2026/27, the projected annual revenue loss from all anticipated migrations is expected to be $29.7 million compared to FY 2023/24 revenue.

CDT is supporting state departments that are currently in the process of migrating from SDC services to successfully complete their migration plans. The decline in utilization is expected to stabilize in FY 2028/29 as the departments complete their migration process. As subscriptions decline, the fixed costs to maintain these services are divided between fewer entities, driving up costs for the remaining ones. CDT is sensitive to this. Migrating off these systems is complex and time intensive. CDT strives to help organizations coordinate their migrations to avoid leaving a single entity shouldering an outsized cost burden. We provide departments with options to move to other CDT-managed services. These options help reduce security and compliance challenges while saving overall migration expenses.

Revenue and Expense Forecasting

CDT forecasts revenue and expense trends through June 2027 based on utilization, rate increases, and adopting new service offerings or configurations. New service configurations allow the SDC to meet demand by adjusting an existing service line to

match customer needs. For example, the SDC is upgrading circuits to enhance functionality.

CDT is working with Finance to develop a FY 2025/26 rate package that will help offset the revenue and expense difference displayed below in both the "2025-26" and "2026-27" columns. The rate package is not reflected in the chart below and is estimated to increase revenues by approximately $3.9 million per year.

Forecasted Change in SDC Revenue & Expense

	2024-25	2025-26	2026-27
Revenue*	$ 205,644,896	$ 196,768,746	$ 180,015,456
Expense	$ 198,678,254	$ 197,884,615	$ 197,312,631
Difference	$ 6,966,642	$ (1,115,869)	$ (17,297,175)

*Revenue projections include approved Rate Changes in Fiscal Year 2024-25.
*Revenue projections do not reflect the positive impact of new and/or mandatory services.
**Projections include the subscription forecasting information shown in the previous table and the efficiency plan outlined in the "State Data Center Expense Reductions" section below.

Cost Cutting Successes

CDT has successfully concluded its multi-year plan to reduce both operating expenses and personal services costs within the SDC. Actual reductions have exceeded the target of $10.5 million by approximately $70,000. The SDC reduced 45 positions, resulting in cost savings of $6.84 million. Additionally, we have implemented new IT solutions to further reduce operating expenses by $3.73 million. The $3.73 million comprises $2.28 million in contract eliminations, $1.04 million in software licensing reductions, and $.41 million in hardware savings due to new service efficiencies. The reduction in staffing and operating expenses has reduced the overall cost structure. Although the SDC has exceeded its cost-cutting goals, it will continue to seek efficiencies in its cost structure by embracing change and reducing the costs passed on to customers.

The following chart details the savings achieved by CDT's Office of Technology in an organizational structure view. All the reductions occurred between FY 2022/23 and FY 2024/25 and were achieved exclusively in the Technology Services Revolving Fund and did not utilize any reductions in pass-through types of services. It should be mentioned that direct services support a particular service while indirect services provide a benefit to multiple services. The costs allocated are based on established methodologies. Of the total $10.5 million in cost reductions, $7.5 million was reduced from direct services and $3 million came from indirect services. A service area is under-recovering when its direct and indirect expenses exceed the revenue generated by that area. Fifty-seven percent of the direct service reductions were from under-recovering service areas.

Organizational Structure View of Savings Achieved

Division / Reporting Unit		Savings
CALNET	**$**	**311,489**
CALNET Program	$	311,489
Data Center Support Services	**$**	**2,061,535**
Computer Room & Business Support	$	434,700
Customer Engagement Services	$	370,898
Service Management Operations	$	1,255,937
Infrastructure	**$**	**4,344,899**
Compute & Storage	$	2,669,391
Enterprise Network	$	1,675,508
Office of Technology Services	**$**	**250,000**
Office of Technology Services	$	250,000
Platform	**$**	**3,600,422**
Mainframe Services	$	2,058,952
Unix Services	$	1,178,288
Windows Services	$	363,182
Grand Total	**$**	**10,568,345**

The SDC's focus is not exclusively on cost reductions and cost recovery. The SDC must maintain legally obligated or critical services even when full cost recovery is not possible. Constraints such as customer migrations, outdated customer software or equipment, and inflation impact our ability to recover fully. As aforementioned in the subscription section, if utilization of a critical service drops to a level that the few remaining customers cannot financially maintain, we will continue to support services to maintain systems critical to the state.

CDT's Next Steps for Financial Stability

The SDC recognizes that the existing funding model needs further improvement to avoid the inequity created for SDC customers when the only option to recover operating costs from other non-SDC CDT programs is through SDC rates. Through the rate benchmarking process, CDT has determined that no directly comparable public sector technology organizations serve a state with the same scope, scale, and complexity as California.

After analyzing the SDC financial model, CDT has implemented the following:

1. Requiring state departments to consider CDT's programs and services before seeking alternative options. CDT has developed the California Cloud Services Assessment tool to help implement this policy, which aims to minimize unnecessary exemptions and reduce customer migrations.

2. Implementing service portfolio processes that identify and eliminate antiquated technology services and create new programs and services to meet customer needs.

3. Continuing to evaluate the cost components of our services.

State Data Center Policy Changes

During FY 2024/25, CDT continues to evaluate SDC policies to ensure alignment with statutory mandates and to meet our customers' evolving needs.

As part of the GenAI EO, the Government Operations Agency, Office of Data and Innovation (ODI), Department of General Services (DGS), and CDT collaborated to use a product-based approach to implement updated State project approval policies, processes, and procedures related to projects using GenAI technologies. This changed CDT's governance structure to ensure that future customer IT projects meet the needs of the entire State rather than exclusively focusing on the needs of a single department.

While CDT is not planning to implement term agreements for SDC services, we will periodically review their viability and implement them on a case-by-case basis if they are deemed to benefit from the stability of the service, the department, and customers.

Since the release of Technology Letter (TL) 23-03 (Cloud Smart policy), CDT has successfully consolidated multiple cloud offerings into a centralized managed cloud service. It has received the support of several recent adopters, including the California Department of Human Resources' CalCareers / Examination and Certification Online System (ECOS), thereby eliminating ongoing hardware and software licensing costs.

CDT is working to address GC 11546.45 (b) to identify and implement additional centralized contract opportunities with the intent to leverage the State's buying power to ensure the lowest pricing to the benefit of all state entities.

Additionally, CDT is exploring a statewide contract solution that would provide all state departments with access to network telecommunications services, collaboration tools, and IT maintenance within a consolidated agreement. When executed, this statewide agreement would standardize a reduced pricing model across all state departments. This effort would provide cost savings and more flexibility to pay for what the department uses, reduce multiple and duplicative contracts, inconsistent pricing, and lack of parity in purchasing across departments. This endeavor will introduce a better payment model for CDT as the contract holder and state entities benefit from a simplified contract management approach. When successful, this agreement will serve as a blueprint for modern shared service contracts that benefit departments statewide.

CDT will continue to evaluate IT policies and services to meet the state's needs and evolving demands. We endeavor to take a flexible product-based approach. We continue to capitalize on cloud architecture, shared platforms and services, and partnerships with a variety of technology providers to drive down customer costs. These

strategies provide a larger variety of services to state entities, increase subscription utilization rates, and drive more value for our customers.

Ultimately CDT strives to be the value-add service provider to the state providing reliable, scalable, modern, and secure solutions that meet the diverse needs of all Californians.

If you have any questions or would like to discuss this report, please feel free to contact me at Liana.Bailey-Crimmins@state.ca.gov.

Respectfully,

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State CIO and Director
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cc: Honorable Jesse Gabriel, Chair, Assembly Committee on Budget
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