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California State Senate

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

ROOM 5019, STATE CAPITOL
SACRAMENTO, CA 95814

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COMMITTEE ASSISTANT
GLENDA HIGGINS
MARY TEABO

(916) 651-4103
FAX (916) 323-8386

Agenda
May 24, 2013
Room 4203
9:30 a.m. or upon adjournment of Session

Governor's Proposal	Comments

0860-001-0001 Board of Equalization

Governor's Proposal	Comments
Accounts Receivable Workload The Governor's budget did not contain a proposal for this item. Over the last few years, as a result of staffing reductions, furloughs and redirections, the inventory of accounts receivable related to sales tax liabilities has increased substantially, and now stands at approximately $2.0 billion. As these accounts age, they become increasingly difficult to collect and, eventually, must be written-off. The department has developed a proposal for three-year, limited-term positions that would engage in collection efforts for these accounts, in an effort to reduce the inventory and increase state and local revenues. The state General Fund, special funds and local governments would all benefit from the collection efforts and share in the costs. After the limited-term positions expire, the department's new Centralized Revenue Opportunity System (CROS) would be used for much of the collection activities. The proposal is estimated to result in additional General Fund revenues in 2013-14 of $15.2 million ($10.0 million, net of costs) and $27.1 million ($18.0 million net of costs) in 2014-15.	Collection efforts would be expanded by 68.3 LT positions in the budget year, requiring $7.6 million ($5.4 million GF) and generate $30.5 million in revenues ($15.2 million GF). Positions would expand to 128.5 LT, requiring $12.8 million in resources, generating $54.2 million in revenues. General Fund revenues, net of costs, would be $10.0 million in 2013-14 and $18.0 million in 2014-15. **Staff Recommendation:** Approve the proposal for limited-term positions and recognize $15.1 million in General Fund revenue.

0860 Board of Equalization

Governor's Proposal	Comments

0860-001-0001 Board of Equalization

Clarify Sales Tax on Software The Administration has requested the adoption of trailer bill language that would clarify that software delivered on media (such as discs, tapes, or other storage devises) is tangible personal property subject to sales tax provisions. The clarification would consist of an amendment to subdivision (a) of Revenue and Taxation Code section 6010.9 as well as in non-codified language in the bill indicating that the language is declaratory of existing law. The amendment to Revenue and Taxation Code section 6010.9 would read as follows: a) "Storage media" includes but is not limited to, punched cards, tapes, discs, diskettes, or drums on which computer programs may be embodied or stored. Notwithstanding any other provision of this part, a computer program embodied or stored on storage media is tangible personal property. The proposal was heard in Senate Subcommittee #4 and held open at the request of the Chair to get further clarification regarding the language.	The current structure of the Revenue and Taxation Code indicates that the Legislature has intended that software delivered on media be considered tangible personal property. The Code specifically exempts the sales of custom software from the sales and use tax, which would not be necessary if software on media was not considered tangible personal property. This trailer bill language simply ensures that the current state of law for the taxation of prepackaged software is maintained. **Staff Recommendation:** Approve proposed trailer bill language.

Investment in Mental Health Wellness (Handout). A renewed investment in community-based mental health treatment options is imperative. CA has experienced a notable reduction in Psychiatric beds, and many emergency rooms have become de facto providers of mental health services with one-fifth of people with severe disorders visiting a hospital emergency room at least once a year. Many individuals can be served very effectively through community-based treatment programs which are eligible for Medi-Cal reimbursement. Expanded capacity is necessary to treat AB 109 populations and reduce recidivism, to address needs in the Medi-Cal expansion population, and to offer early intervention treatment options to lower future costs in both human capital and dollars. An investment of $206.2 million ($142.5 million one-time GF) is recommended to: • Provide increased crisis residential program capacity of at least 2,000 beds; • Fund 25 Mobile Crisis Support Teams; • Add at least 600 triage personnel in select rural, suburban and urban regions; • Establish additional Crisis Stabilization Units (less than 24-hours); • Provide Peer Support training in crisis management and suicide prevention ; and • Establish consensus guidelines for involuntary commitment care under Section 5150. The two-page Handout articulates the funding sources, appropriations and proposed trailer bill and Budget Bill language actions.	Staff Recommendation: Adopt Handout

Governor's Proposal	Comments

3360-001-0465 Energy Resources Conservation Development Commission

Governor's Proposal	Comments
Proposition 39—Technical Assistance Program for School Districts **May Revision Proposal.** The May Revision proposes $4 million and eight positions for the California Energy Commission, to provide technical assistance to small local educational agencies. This funding is intended to help identify cost-effective energy savings opportunities for K-12 school facilities, and to provide guidance on establishing baselines and tracking performance. This technical assistance program is proposed to be funded by the Energy Resources Program Account. The greater Proposition 39 May Revision proposes to allocate $400.5 million from the Proposition 98 General Fund to K-12 local educational agencies, on a per-ADA basis to support energy efficiency projects. This is an increase of $12.5 million, based on revised revenue estimates from January. The method of funding is relatively unchanged. The proposal does include a minimum grant level of $15,000 to exceptionally small local educational agencies. Please see related item on page 18.	The Governor's proposal attempts to give some assistance to schools for their use of Proposition 39 funding. This could be achieved at the local level, to a greater degree, by adding trailer bill language that requires school districts to certify with a public utility, prior to expenditure of funds, that the expenditures will be used on cost-effective energy efficiency projects. **Staff Recommendation:** Reject proposal. Adopt placeholder trailer bill language to require schools to certify with a public utility, prior to expenditure of funds, that the expenditures will be used on cost-effective energy efficiency projects.

Governor's Proposal	Comments

3900-011-3228 California Air Resources Board

Cap and Trade Program—Loan to the General Fund The Governor's May Revision proposes to loan $500 million from the Greenhouse Gas (GHG) Reduction Fund (Cap and Trade auction revenues) to the General Fund. While the Air Resources Board (ARB) submitted its three-year "Cap and Trade" Auction Proceeds Investment Plan with the May Revision, as required by Chapter 807, Statutes of 2012 (AB 1532, Pérez), the Governor's May Revision did not include the highly anticipated expenditure plan that was to accompany it. The goal of the State's climate plan is to reduce Green House Gas (GHG) emissions to 1990 levels by the end of this decade. The Cap and Trade program, a key element in this Administration's plan to achieve these goals, sets a statewide limit on the sources of greenhouse gases and establishes a financial incentive for long-term investments in cleaner fuels and more efficient energy use. The ARB has conducted three auctions of GHG emission allowances, as part of a market-based compliance mechanism. These auctions have resulted in an approximated $270 million in proceeds to the state. This is significantly less than the $1 billion in cap and trade revenues anticipated in the Governor's proposed 2012-13 budget.	The shift of funding away from the purposes for which the funds were received is not consistent with previous Administration statements, and confuses the issue of reduction of greenhouse gas emissions with Cap and Trade revenues by 2020. The lack of a repayment date for the General Fund loan, coupled with the lack of effort to identify current and ready-to-move projects, does not seem in keeping with statements of the Air Resources Board and Governor in the past year. **Staff Recommendation:** Move to Conference Committee by adopting May Revision proposal.

Governor's Proposal	Comments

3960-001-0014 Department of Toxic Substances Control

Governor's Proposal	Comments
Hazardous Waste Fee Reform (TBL) **Governor's Proposal.** The Governor proposes trailer bill language to modify the hazardous waste fees, in the Hazardous Waste Control Account (HWCA), to simplify the hazardous waste fee system, align the fees with public policy and program objectives, assess the fees more fairly on those who generate waste, and provide more stability to the funding source for Department of Toxic Substances Control's (DTSC) Hazardous Waste Management Program. Specifically the proposal: (1) Eliminates four existing fees including the Disposal Fee, Manifest User Fee and EPA ID Verification Fee. (2) Replaces a tiered fee structure with a flat rate, per ton. (3) Removes caps on amounts charged on disposers of hazardous waste. (4) Brings the fee structure into compliance with Proposition 26 by creating a more equitable fee structure.	The Governor's proposed restructuring is necessary to set fee levels to cover the cost of the hazardous waste management program, more fairly distribute the fee burden to the regulated fee payers, and provide stability and sustainability in the HWCA. This proposal simplifies the hazardous waste fee system, reduces the number of different fees paid by most hazardous waste generators, facilities, and transporters, creates a more equitable fee system, and allows DTSC to be reimbursed for its full costs. **Staff Recommendation:** Adopt Trailer Bill Language.

Governor's Proposal	Comments

4260-101-0001 Medi-Cal, Local Assistance

Medi-Cal Adult Dental Benefits	
Adult Dental Services, with the limited exception of "federally required adult dental services" (FRADS) and dental services to pregnant women and nursing home patients, were eliminated as an "optional" Medi-Cal benefit in 2009, due to the state's fiscal crisis. Generally, FRADS primarily involves the removal of teeth and treating the affected area. The Governor does not have a proposal regarding Medi-Cal Adult Dental Benefits.	The elimination of Adult Dental Services created a dramatic impact on the oral health and overall health of millions of Medi-Cal enrollees. With the expansion of Medi-Cal to certain childless adults, under federal health care reform, the state could take advantage of the 100 percent federal funding (for the first three years) for these new enrollees. The federal government would be paying for 100 percent of the costs associated with the restoration of Adult Dental Services for the newly eligible. Staff Recommendation: Fully restore Medi-Cal Adult Benefits for a cost of $131 million General Fund.

Governor's Proposal	Comments

4260-101-0001 Medi-Cal, Local Assistance

Governor's Proposal	Comments
Managed Care Organization (MCO) Tax The May Revision proposes a permanent reauthorization of a tax on Medi-Cal managed care plans: • In 2012-13, the tax rate would be equal to the gross premiums tax (2.35 percent), to generate $128.1 million General Fund savings. The current year revenues would be directed to the Healthy Families Program. • In 2013-14, and beyond, the rate would be equal to the state sales and use tax rate (3.9375 percent) and would generate about $342.9 million in General Fund savings on an ongoing basis. The budget year and out year revenues would be directed to Medi-Cal managed care rates for health care services for children, seniors and persons with disabilities, and dual eligibles.	With the expiration of the MCO tax on June 30, 2012, the state is forgoing hundreds of millions of dollars in additional federal funding for the Medi-Cal program, as the MCO tax can be used as a match for federal funding for Medi-Cal. A permanent authorization of this tax would make it difficult to periodically evaluate its effectiveness and impact on Medi-Cal managed care. Staff Recommendation: Approve (1) reauthorization of the tax at the gross premiums tax rate for the current year and (2) at the sales and use tax rate for 2013-14 and 2014-15.

Governor's Proposal	Comments

4260-101-0001 Medi-Cal, Local Assistance

Governor's Proposal	Comments
Mandatory Medi-Cal Expansion Under Federal Health Care Reform The Administration proposes $186.7 million General Fund in 2013-14 for the increase in Medi-Cal caseload, as a result of the Medi-Cal simplification provisions of the federal Affordable Care Act (ACA), referred to as the "mandatory" expansion. The LAO finds that the General Fund costs associated with this expansion is $104 million General Fund in 2013-14. (This is the LAO's moderate-cost estimate, which it considers the most likely.)	The Administration's estimate is built on questionable assumptions, including a very ambitious rate in which individuals would take-up coverage, a high caseload growth rate, and the failure to account for natural program attrition. Staff Recommendation: It is recommended to adopt the LAO's fiscal estimates (of $104 million General Fund) as the costs for this new caseload. The LAO's numbers are based on research and adhere to a generally accepted methodology.

Governor's Proposal	Comments

4260-101-0001 Medi-Cal, Local Assistance

Governor's Proposal	Comments
Medi-Cal Expansion Under Federal Health Care Reform– County "True Up" Mechanism The May Revision proposes that a mechanism be developed to determine the level of county savings as individuals, who were previously uninsured and covered under county indigent health care, gain coverage through Medi-Cal expansion or through health coverage available through Covered California (California's Health Benefit Exchange). The proposed mechanism would account for actual experience and would reflect county costs for providing services to Medi-Cal and uninsured patients and the revenues received for such services. This mechanism would apply consistently to all counties irrespective of if the county is a public hospital county (12 counties), a County Medical Services Program county (35 counties), or provides indigent care under a different model (11 counties). The details of this proposed mechanism have not been provided to the Legislature.	Significant concerns have been raised by various stakeholders regarding this proposal. Counties and other stakeholders contend that there are too many unknowns in regard to how individuals might receive coverage and that counties need to maintain adequate funding for ongoing indigent care, public health responsibilities, and infrastructure development. Staff Recommendation: Adopt modified placeholder trailer bill language. The Legislature's mechanism would take into consideration the differences between counties and would ensure counties maintain adequate funding for their responsibilities.

Governor's Proposal	Comments

4260-101-0001 Medi-Cal, Local Assistance

Governor's Proposal	Comments
Prior Year Rate Reductions for Distinct Part/Nursing Facilities-Level B (DP/NFs) As part of the 2011-12 budget (AB 97, Statues of 2011), the state imposed a 10 percent reduction in the rates to be paid to all fee-for-service Medi-Cal providers. In addition, payment rates for distinct part skilled nursing facilities (located on a hospital campus) were "rolled back" to the rates in place in the 2008-09, and then reduced by 10 percent. The federal government has approved the proposed rate reductions. However, implementation has been enjoined while legal challenges to the reductions proceed. The Governor does not have a proposal regarding the rates for these facilities.	Staff Recommendation: It is recommended to restore $42 million General Fund towards the rates for these facilities. This restoration would unfreeze their rates and adjust the rate level to be in line with 2013-14 rates. The 10 percent reduction, required by AB 97, would still apply. These nursing facilities are often the only option for patients with complex medical and behavioral health needs, particularly in rural communities. These facilities are doubly impacted by the AB 97 reductions.

Governor's Proposal	Comments

4300-003-0001 Department of Developmental Services

Governor's Proposal	Comments
Sonoma Developmental Center (SDC) The May Revision reflects new proposals for up to $37.9 million ($35.0 million GF), across 2012-13 and 2013-14, including: 1) A $7.4 million GF increase in 2012-13, and a $15.7 million GF increase in 2013-14, to backfill lost federal funding. The federal fund loss is tied to the withdrawal of four residential units within SDC from federal certification, in the wake of findings regarding multiple instances of abuse, neglect, and lapses in caregiving at SDC. The 2012-13 funding was also included in SB 68, a current-year budget bill. SB 68 was recently passed by both houses of the Legislature. 2) A $300,000 ($200,000 GF) increase in 2012-13, and $2.5 million ($1.7 million GF) increase in 2013-14, to fund a contract with an Independent Consultative Review Expert (ICRE), as required by a Program Improvement Plan (PIP) the state entered into with the federal certification agency. 3) Proposed budget bill language that would allow the Department of Finance to authorize expenditure of up to $10 million GF, and to notify the Legislature 10 days prior to such authorization, in order to address costs that may be necessary to implement the action plan, identified by the ICRE, as a part of the state's PIP. The department indicates that the, as yet unidentified, costs might include costs associated with additional staffing or training.	With approximately 500 total residents, SDC is authorized for around 1,500 state staff positions and has a 14 percent staff vacancy rate. The Governor's January budget also proposed an additional $2.4 million increase ($1.3 million GF) to allow the facility to hire approximately 36 additional direct care staff. Subcommittee 3 approved that requested funding, but with authorization for the positions for a limited-term of two years. The LAO recommends approving the federal funds backfill and ICRE funding, but rejecting the proposed budget bill language to authorize up to an additional $10 million GF. **Staff Recommendation**: See handout.

Governor's Proposal	Comments
Local Control Funding Formula (LCFF) **Overall Funding**. The Governor's May Revise provides an additional $240 million in Proposition 98 funding, above the January budget, to increase base resources for LCFF in 2013-14. The Governor's proposal brings total new funding for LCFF to **$1.9 billion** in 2013-14, the first year of implementation. Of the $240 million increase proposed by the Governor, $236 million is provided for school districts and charter schools and $4 million is provided for county offices of education in 2013-14. **Formula-Related Modifications.** The Governor proposes several modifications to the LCFF funding formula including changes to smooth year to year growth and cost-of-living adjustments, extend limitations for English learner funding from five to seven years, and utilize a three-year rolling average of low-income and English learner counts, rather than prior-year counts. **Expanded Fiscal Accountability Provisions.** The May Revise proposes to require local educational agencies (LEAs) to LCFF funding for the "primary benefit" of students generating the funds and requires LEAs to allocate supplement and concentration funds to school sites proportionally to the number of low-income English learner and foster youth students at those schools. **Expanded Academic Accountability Provisions:** The May Revision proposes a tiered structure of support and intervention, modeled after the existing AB 1200 structure, for districts and county offices that struggle to meet their academic obligations. The State Board of Education would adopt standards and criteria to evaluate whether a district or county office is able to meet these obligations. Beginning in the 2015-16 fiscal year, county superintendents and the Superintendent of Public Instruction would have the authority to require districts and county offices to make changes to their local control and accountability plans, if the districts or county offices have not met state API targets, for multiple years, for (1) all students, (2) English learners, (3) students from low-income families, and (4) foster children. **Senate Alternative:** The Senate proposes to set aside $2.2 billion for the Governor's proposal -- $331 million beyond the Governor's May Revise funding level – pursuant to provisions of SB 69 (Liu), which (1) commences implementation in 2014-15; (2) redirects concentration funding to enhanced base and supplemental funding; and (3) includes a different set of accountability provisions.	**Senate Recommendation:** Approve a total of $2.2 billion in new base and categorical funding for K-12 schools in 2013-14. This provides an additional $331 million beyond the $1.9 billion for LCFF proposed by the Governor. Implement a new Local Control Funding Formula in 2014-15 pursuant to the provisions of SB 69 (Liu).

Governor's Proposal	Comments
K-14 Payment Deferral Buydowns **Inter-Year Payment Deferrals – K-14 Education:** The Governor's May Revise accelerates and increases inter-year payment deferrals for both K-12 schools and the community colleges. Overall, the May Revision retires an additional **$760 million** in deferrals in the current and budget years, relative to the January budget ($4.2 billion total deferral payments in January, $4.9 billion in the May Revision), as follows: • **Current Year – Additional Deferral Paydowns**. Increases deferral paydowns by **$1.8 billion** for K-14 education, which brings the total deferral paydown to **$4.0 billion i**n 2012-13. [The additional $1.8 billion in deferral buydowns includes $1.6 billion for K-12 education and $180 million for community colleges in 2012-13.] • **Budget Year – Reduction in Deferral Paydowns.** Reduces deferral paydowns by **$1.0 billion** for K-14 education, which brings the total deferral paydown to **$920 million** in 2013-14. • [The $1.0 billion reduction of deferral paydowns includes $909 million for K-12 education and $115 million for community colleges in 2013-14.] Ongoing K-14 deferrals – utilized to mitigate programmatic reductions for K-12 schools and community colleges – reached an all-time high of $10.4 billion in 2011-12. The 2012-13 budget act reduced K-14 deferrals to $8.2 billion. The Governor's May Revise will further reduce K-14 deferrals to a total of $5.5 billion in 2013-14.	**Senate Recommendation:** **Current Year**. Approve the Governor's May Revise proposal to provide an additional $1.8 billion in deferral buydowns in 2012-13. **Budget Year.** Approve an additional $1.1 billion in deferral buydown for K-12 education and an additional $134 million in deferral buydown for the community colleges beyond the Governor's May Revise in 2013-14.

Governor's Proposal	Comments
Common Core Implementation In August 2010, the State Board of Education revised the state's existing academic standards in English language arts and mathematics to align with the Common Core State Standards developed by the National Governor's Association and Council of Chief State School Officers. In response, the Governor proposes $**1 billion** in one-time Proposition 98 funding for school districts, charter schools, and county offices of education, for the purpose of implementing these State Board adopted "Common Core" academic content standards in 2013-14. Funding is allocated to these local educational agencies "not sooner than September 16, 2013", and is available over a two year period. Per the Governor, the $1 billion, one-time, investment allows local educational agencies to make significant one-time investments in professional development, instructional materials, and technology necessary to implement Common Core standards. The $1 billion is apportioned to local educational agencies on the basis of average daily attendance (ADA) and provides an average of $170 per pupil, outside of the Local Control Funding Formula. Funding shall be expended by local educational agencies based upon a plan approved by its governing board or body. The governing board or body shall hold a public hearing on the plan prior to adoption of the plan in a public meeting. Common Core standards, for purposes of the Governor's proposal, are defined as academic content standards adopted by the State Board of Education pursuant to Education Code Sections 60605.8, 60605.10, and 60605.11. The statutory provisions cover content standards for both: English language arts (ELA) and (2) mathematics. The Governor proposes trailer bill language to appropriate the $1 billion in one-time funding. While funds are appropriated in 2013-14, these one-time funds are attributable to the 2012-13 fiscal year for purposes of meeting the Proposition 98 minimum funding guarantee.	There is no doubt that additional one-time funding would be helpful to local educational agencies in implementing common core standards and preparing for related changes in assessments. However, it is not known how much funding is actually needed. Some large districts are well underway with implementation, which was financed through existing resources. The Governor's proposed trailer bill language is broadly written given the large amount of one-time funding involved. **Senate Recommendation:** Approve $1 billion per the Governor's proposal, but modify trailer bill language to better assure that funding is used for intended purposes.

Governor's Proposal	Comments

6110 Department of Education

Career Technical Education Innovation Grants The Senate seeks to ***build stronger connections between our schools and businesses*** to better prepare our students for the jobs of the 21st century by placing a greater emphasis on ***career-based learning as a central mission of public education*** in California. The Senate proposes to appropriate **$250 million** in the 2013 -14 California state budget to capitalize the ***California Career Pathways State Revolving Fund***. The state fund would funnel state assistance to local educational agencies through competitive grants, with priority giving to proposals that attract capital and in-kind contributions from business and serve distressed communities with high dropout rates. The goal of the program would be ***to leverage the $250 million by a factor of two or three,*** which would vastly expand the resources available for career pathways programs. Although linked-learning programs operating in California today through the Regional Occupational Centers and Career Partnership Academies generally have been demonstrated to improve the future prospects of their graduates, the current programs have had ***limited success in attracting business support***, and rely on minimal state appropriations that have experienced sharp cuts in recent years. If California is to integrate career-based learning into the mainstream high school curriculum, government and business must join together in a much bigger commitment. The $250 million appropriation will provide the resources to allow local educational agencies to enter into multiyear agreements with businesses, in a way that would not be possible if the Legislature were to enact small, incremental changes to the existing categorical programs in the CDE budget.	**Senate Recommendation:** Approve $250 million in one-time Proposition 98 funding for a new Career Technical Education Innovation Grant program beginning in 2013-14.

Governor's Proposal	Comments
Adult Education Program Proposal. The Governor's May Revise rescinds the January proposal that would have provided community colleges with **$300 million** in base funding for adult education in 2013-14. Instead, the Governor proposes to provide **$30 million** in 2013-14 for community colleges and school districts (through their adult schools), to create joint plans for serving adult learners in their area. The Governor proposes both budget bill language and education trailer bill language to implement the new proposal. Under the May Revise proposal, $30 million in Proposition 98 funds are appropriated to the community colleges in 2013-14 for adult education planning grants. These funds will be distributed to regional consortia of community colleges and school districts. Grant awards will be selected by the California Community Colleges Chancellor's Office and the California Department of Education. The regional consortia will create a plan to serve adults in the region. Providers would have two years to form regional consortia and develop plans for coordinating and integrating services. Regional consortia participants could include local correctional facilities, other public entities, and community-based organizations. Beginning in 2015-16, the Administration proposes to provide **$500 million** in Proposition 98 funding for a new **Adult Education Partnership Program,** which will provide funding to the regional consortia to deliver adult education. This new funding will be appropriated to the Chancellor's Office. In order to be funded, regional consortia shall include, at a minimum, one community college district and one school district. The community college shall act as the fiscal agent for the grant. Consistent with his approach in January, the Governor limits funding for the Adult Education Partnership Program to five "core instruction areas", including: adult elementary and secondary education, vocational training, English as a second language, adults with disabilities, and citizenship. The funding rate for the regional consortia will be based on the career development college preparation rate (enhanced non-credit rate) of **$3,232** per full-time equivalent student. This rate would be subject to annual cost-of-living adjustments. Of the funds made available for the Adult Education Partnership Program, a minimum of two-thirds of the total shall be restricted to existing providers in the regional consortia, if they maintain their 2012-13 levels of state funded spending for adult education and correctional education in 2013-14 and 2014-15.	**Staff Recommendation:** Approve $30 million per the Governor's proposal with modified trailer bill language to enhance collaboration between K-12 education and community colleges.

6110-139-8080 Department of Education
6870-139-8080 California Community Colleges

Proposition 39 Energy Efficiency Education Programs.	Staff Recommendations:
The Governor's May Revise proposes a total of **$464 million** in Proposition 98 funding for energy efficiency programs for K-12 schools and community colleges resulting from additional Proposition 39 revenues in 2013-14. This is $14 million above the January budget to reflect additional estimated Proposition 39 revenues. With these May Revise updates, the Governor proposes the following allocation of these funds in 2013-14: • **$413 million** to the California Department of Education (CDE) for K-12 education allocated on a per average daily attendance (ADA) basis to school districts, charter schools and county offices of education in 2013-14. The May Revise adds trailer bill language to implement a $15,000 minimum grant for exceptionally small schools (less than 200 ADA) and $50,000 for all other small schools. • **$51 million** to the Community College Chancellor's Office for community colleges allocated on the basis of full-time equivalent students. The Governor's January budget proposes **$109,000 GF and 1.0 position** for the Department of Education to implement and oversee the Proposition 39 energy efficiency program in 2013-14. The Governor does not propose additional funding or positions for implementation of the new program at the community colleges in 2013-14. **(See related agenda issue on page 4.)**	Approve $464 million proposed by the Governor for K-12 schools and community colleges. Allocate funding for K-12 schools pursuant to legislation passed in the 2013-14 Legislative Session. Allocate community college funding per the Governor's proposal. Adopt May Revise trailer bill language to establish minimum grant sizes for small schools. Include the three State Special Schools in the K-12 program allocation. Approve Governor's January request for $109,000 and 1.0 position at CDE to implement the program.

Enterprise Zones/Economic Development

Governor's Proposal	Comments

Enterprise Zone Tax Incentives and Economic Development

Governor's Proposal	Comments
Reform and Repurposing of Enterprise Zone Tax Incentives The Administration has proposed trailer bill language that would reform the state's job creation and economic development incentives. The proposal is designed to be revenue neutral and focus on improving the performance of resources being used to better stimulate economic growth and the creation of jobs. The program is based on redeploying the resources currently committed to the Enterprise Zone programs and the New Jobs Credit. The May Revision proposes to modernize the state's job creation and economic development incentives by reshaping existing programs to meet the need of the current economy. This program would include the following: (1) hiring credit for businesses in specific areas with high unemployment and poverty rates; (2) sales tax exemption on manufacturing and biotech research and development equipment; and, (3) incentive fund to provide business tax credits in exchange for investments and employment expansion in California. The program would allow small businesses to easily obtain the manufacturing sales tax exemption, and will dedicate a portion of the hiring credit and the incentive fund solely to small businesses.	The reform proposal represents a substantial improvement to current enterprise zone tax incentives. A substantial body of research indicates that these incentives do not create additional employment in the state. The proposal is revenue neutral and thus has no direct effect on the budget year, but should have significant impacts on the effectiveness of this significant "tax expenditure" program. **Staff Recommendation:** Adopt placeholder trailer bill language regarding enterprise zone incentive and economic development reform.

Job Creation and Economic Development Proposal

Background Perspective. For over 25 years, California has created numerous Enterprise Zones, as well as other geographically-targeted economic development areas. Currently, there are 40 authorized Enterprise Zones; this number is expected to continue to decline as authorizations expire and ongoing regulatory changes and audits are completed. These programs include many aspects, chief of which is a tax credit for new hires. In total, the tax benefits related to these programs currently cost the state about $750 million per year. In its current form, existing Enterprise Zones fail to encourage the creation of new jobs and instead reward moving jobs from one place to another within the state, according to unbiased economic research. This, along with California's persistently high unemployment rate, argues for changes to encourage economic development and increase the number of jobs in California.

In 2009, the New Jobs Hiring Credit was created to support creation of new jobs through small businesses. To date, approximately $160 million has been claimed, resulting in annual costs of approximately $30 million to $40 million annually. Based on the lifetime cap for this program, approximately $240 million remains to be allocated.

Under current law, California requires a sales tax to be paid by manufacturers on the purchase of manufacturing equipment. When taxes are applied to purchases of manufacturing equipment, the final goods produced by that equipment are effectively taxed at more than the statutory rate. This leads to different effective tax rates for different types of goods (and higher tax rates for goods produced in California versus those same products produced outside of California). California is one of the few states that impose a sales tax on the purchase of manufacturing equipment. California firms have to pay more for the same manufacturing equipment as their competitors in other states, just because of the sales tax. The state share of sales tax for these purchases is approximately $600 million annually.

Proposal Components. The Administration proposes to reshape the state's economic development tax programs by phasing out the current Enterprise Zone tax programs. Taxpayers would be allowed to continue using Enterprise Zone carryover credits for five years, and would be able to continue to use generated hiring credits for employees under contract prior to January 1, 2014. The Administration's initiative would establish the following programs:

- **Hiring Credit.** The hiring credit will be refocused to specific areas with high unemployment and poverty rates both inside and outside existing zones. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, and people receiving public assistance. Twenty-five percent of the funds will be targeted to small businesses. The credit would be equal to 35 percent of wages between 1.5 and 3.5 times the minimum wage for a period of five years, and available only to businesses that have a net increase in jobs in the state. It is expected that this program component would provide $100 million in credits annually.

- **Sales Tax Exemption.** The existing sales tax exemption for businesses located in Enterprise Zones will be expanded to a statewide sales tax exemption on manufacturing or biotech research and development equipment purchases. A business will be allowed to exclude the first $200 million equipment purchases from the state share of sales tax (4.19%). Such exemptions from the sales tax would be subject to the regular routine audit process. The program component is estimated to provide sales tax exemptions worth over $400 million annually.

- **Investment Incentives.** The California Competes Recruitment and Retention Fund will be created and will be administered by the Governor's Office of Business and Economic Development (GO-Biz). Businesses will have the opportunity to compete for available funds, based on specified criteria including the number of jobs to be created or retained, wages that are at least two times the minimum wage, and a set job retention period. GO-Biz will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California. Approval of any proposed incentive will be made by an allocation committee that may recapture the incentive if the business fails to fulfill the terms and conditions of the contract. A portion of the incentive funds will be awarded solely to small business. The program component would provide between $100 million and $200 million in credits annually.

LAO Perspective. There are numerous details to be fleshed out in the proposal, but LAO indicates that there are some positive parts of this proposal—specifically, scaling back the ineffective enterprise zone program and reducing certain manufacturing sales taxes. Such taxes are the result state tax provisions that create "tax pyramiding"—economically distortionary phenomenon whereby businesses pay sales tax on their equipment and their customers then pay additional sales tax on the final product itself. On the other hand, LAO indicates skepticism that the hiring credit and incentive fund can be designed in ways that achieve their stated goals without providing windfall gains to businesses for decisions they would have made even without the tax incentives. LAO's general advice, which has been consistent over time, is that the Legislature move toward state tax changes that spread the cost of public services over the broadest base possible, with fewer tax expenditures focused on select segments of the economy. By doing this, the state would have the option of lowering certain marginal tax rates and yet be able to collect approximately the same amount of tax revenue.

Staff Comment. At its May 9 hearing, the subcommittee held an overview of the Enterprise Zone incentive programs, including a discussion of their effectiveness and fiscal impacts. As discussed at that hearing, Enterprise Zone tax incentive programs have generally not been found to be effective tools for creating jobs in the state. In addition, the fiscal impact on the state has grown significantly over the last decade.

Major State and Local Revenues

Governor's Proposal	Comments

Major State Taxes

Revenue Assumptions—Personal Income Taxes, Sales and Use Taxes and Corporation Taxes	
The Governor's May Revision incorporates revenue forecasts for the state taxes based on updated economic data. The May Revision is also affected by the adopted accrual methodology, which affects prior years. Overall, based on updated economic information, as well as revenues received by the state in recent months, compared to the January forecast, the Governor assumes revenues to be about $750 million higher over the three year period, 2011-12, 2012-13 and 2013-14. Compared to the January forecast, this translates into $285 million lower in the prior year (2011-12), $2.8 billion higher in the current year (2012-13) and $1.8 billion lower in the budget year (2013-14. While current year revenues are up substantially due to the spring revenue surge, the Administration has lowered its forecast for the budget year from its January forecast, reflecting an assumption that a substantial component of the $4.5 billion additional revenues received over forecasted amounts represents an acceleration of revenues that would otherwise been received in the budget year or out-years. The Administration also assumes lower capital gains realizations than it did in January. The Administration has lowered its 2013-14 forecast for all three major state taxes—personal income tax (PIT), sales and use tax (SUT) and corporation tax (CT)—from its January forecast. PIT is forecast to be down by $3.0 billion; SUT by $300 million; and CT by over $600 million.	The Legislative Analyst's Office (LAO) has forecast revenues that are $3.9 billion higher than the Administration's January forecast for the three-year period. Compared to the Governor's May Revision, LAO's forecast is $700 million higher in the current year, but $2.8 billion higher in the budget year. The LAO indicates that the Administration fails to account for the general increase in asset values, particularly the stock market, and over-attributes recent revenue performance to accelerations. **Staff Recommendation:** Incorporate LAO revenue forecast for the 2013-14 budget.

Governor's Proposal	Comments

Local Property Taxes

Governor's Proposal	Comments
Assessed Property Values The Governor's May Revision includes property tax revenues that offset Proposition 98 spending from the General Fund. These include revenues generated by the local property tax on real property, as well as one-time revenues resulting from the dissolution of redevelopment agencies. Growth in assessed value is the basis on which increased property taxes are generated, and the Administration has forecasted a slight increase in assessed value growth in the budget year and then a leveling off in the out-years. The increase over the budget window is substantially below the typical experience in a recovery period, with growth in 2013-14 of 1.4 percent in 2013-13, 3.0 percent in 2013-14 and 2.5 percent in years thereafter.	The LAO's assumes increases in assessed value which are closer to the normal pattern of increases during a recovery. Their forecast for assessed value growth is 1.63 percent in 2012-13, 3.9 percent in 2013-14 and in excess of five percent thereafter. This results in somewhat less property tax revenues than the Administration's forecast for 2012-13, but $250 million more in 203-14 and over $1.0 billion more in 2-14-15. The LAO's assessed value recovery pattern is actually less optimistic than history would suggest in a recovery period. **Staff Recommendation:** Assume LAO forecast for assessed value growth.