OVERVIEW OF THE 2012-13 BUDGET BILL

Senate Bill 957

As Introduced

Senate Committee on Budget and Fiscal Review

Senator Mark Leno, Chair

February 2012

OVERVIEW OF THE 2012-13 BUDGET BILL

Senate Bill 957

As Introduced

Senate Committee on Budget and Fiscal Review

Senator Mark Leno, Chair

California State Senate

COMMITTEE
ON
BUDGET AND FISCAL REVIEW

ROOM 5019, STATE CAPITOL
SACRAMENTO, CA 95814

SENATOR
MARK LENO
CHAIR

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

February 6, 2012

Dear Colleague:

I am pleased to forward a copy of the *Overview of the 2012-13 Budget Bill*, which has been prepared by the staff of the Senate Budget and Fiscal Review Committee. The document is intended to highlight the Governor's major proposals and provide additional information and framework to support the review of these proposals. This document, as well as further analysis by the Legislative Analyst's Office, will provide the basis for budget hearings throughout the spring.

In the first section, we provide an overview of the state's fiscal condition and the Governor's proposed solutions. The next section, entitled "Major Issues," is organized by budget subcommittee. For each major issue, this report provides background, an explanation of the Governor's proposals, and important issues to consider.

In the Appendix, we include lists from the Department of Finance that itemizes all of the Governor's proposed budget solutions. Also included is a working timeline for completing the 2012-13 budget and a list of budget committee consultants and their respective areas of responsibility.

If you have questions, please do not hesitate to contact me or the committee staff.

Sincerely,

MARK LENO
Chair

TABLE OF CONTENTS

Budget Overview

DEFINITION OF THE OVERALL BUDGET PROBLEM:

The Governor defines the General Fund budget shortfall as $9.2 billion through the period ending June 30, 2013. Of this budget shortfall, $4.1 billion is attributed to 2011-12, and $5.1 billion is attributed to 2012-13. The budget includes a total of $10.3 billion in cuts and revenues to balance and build a $1.1 billion reserve. The Governor's budget assumes revised expenditures in the current year of $86.5 billion General Fund and projects expenditures of $92.6 billion General Fund in 2012-13. To provide some context, state budget expenditures peaked in 2007-08 with expenditures of about $103 billion General Fund.

The budget shortfall in the current year is a result of several factors. Specifically, court orders and delayed federal approval have increased costs in the health and human services area by nearly $2 billion. Furthermore, final revenues from the 2010-11 fiscal year came in significantly lower than anticipated in June 2011 to account for an additional $1.9 billion in erosions. Lower state revenues also contributed to the current year shortfall, but were partially offset by lower costs for Proposition 98 and the implementation of "trigger" spending reductions in the current fiscal year. The elimination of redevelopment agencies, which is the outcome of a recent action by the California Supreme Court, will also result in less General Fund savings in the current fiscal year, but more revenue in future years.

OVERVIEW OF GOVERNOR'S BUDGET PROPOSAL:

The Governor's budget proposal includes $94.3 billion in General Fund resources available and $92.6 billion in total General Fund expenditures, providing for a $1.1 billion reserve. The expenditures in 2012-13 are proposed to be about $6 billion more than revised 2011-12 expenditures. This is mainly a result of additional revenues for K-12 education ($4 billion) primarily from the Governor's proposed Constitutional amendment to raise taxes temporarily and the repayment of the Proposition 1A bonds ($2 billion) issued to repay local government for property tax borrowed to balance the budget in 2009-10. The General Fund budget details are summarized in the table below.

2012-13
General Fund Summary
(Dollars in Millions)

	Revised 2011-12	Proposed 2012-13
PRIOR YEAR BALANCE	**-$3,079**	**-$985**
Revenues and transfers	88,606	95,389
TOTAL RESOURCES AVAILABLE	**$85,527**	**$94,404**
Non-Proposition 98 Expenditures	$53,883	$55,035
Proposition 98 Expenditures	32,629	37,518
TOTAL EXPENDITURES	**$86,512**	**$92,553**
FUND BALANCE	**-$985**	**$1,851**
Encumbrances	$719	$719
Special Fund for Economic Uncertainties	-$1,704	$1,132
BUDGET STABILIZATION ACCOUNT (BSA)	**--**	**--**
TOTAL AVAILABLE RESERVE	**-$1,704**	**$1,132**

CURRENT-YEAR BUDGET UPDATE AND THE 2011 TRIGGER:

The Legislature passed and the Governor signed the 2011 Budget Act in June 2011. The current-year budget made major strides in reducing the out-year structural deficit from $20 billion to about $5 billion. The Governor failed to gain two-thirds legislative support for his original balanced plan for voter-approved taxes and spending cuts. Instead, the enacted budget relied primarily on major cuts in most areas of the budget. At the time of enactment, the cuts totaled $15 billion, bringing GF expenditures down to a level of $85.9 billion against revenues of $88.5 billion. As a share of the economy, this brought General Fund spending to its lowest level since 1972-73.

Part of the 2011-12 budget solution was recognition of unexpected revenue gains at the end of the 2010-11 fiscal year, and a revised revenue forecast that continued this positive trend by adding $4 billion in additional revenue to the 2011-12 forecast. Due to increased risk in the resulting revenue forecast, budget "triggers" were added to reduce spending by an additional amount of up to $2.5 billion if revenues fell below expectations. The final trigger determination was outlined in a December 13, 2011 letter from the Director of Finance – revenues were projected to exceed the May Revision level, but by $1.8 billion instead of the prior estimate of $4 billion. Due to the partial revenue gain, the trigger reduction level was $980 million instead of $2.5 billion – so an additional trigger cut of $1.5 billion to K-12 schools was avoided, as detailed below:

2011-12 Trigger Cuts

Program/Area Reduced	**Cut Amount (in millions)**
K-12 Schools – primarily home-to-school transportation	$328
University of California and California State Universities	$200
California Community Colleges	$102
In-Home Supportive Services program	$101
Department of Developmental Services	$100
Department of Corrections and Rehabilitation (CDCR), including $68 million in increased county charges for youthful offenders	$88
Childcare funding	$23
Local Library Grants	$16
Local Vertical Prosecution Grants	$15
Medi-Cal, extending the 2011 cuts to all managed care plans	$9
TOTAL	**$981**

Accounting for the revised revenues and expenditures – including trigger cuts – as well as other baseline updates, the Governor's revised 2011-12 cut level is $16 billion, with revenues of $86.2 billion, and expenditures of $86.6 billion. Due to a carry-over deficit from 2010-11, and other adjustments for litigation and court action, the Governor estimates the state will end 2011-12 with a deficit of $4.1 billion.

PROPOSED EXPENDITURES BY PROGRAM AREA:

The table below summarizes the Governor's proposed expenditures by program area. The largest change in expenditure by program area is in K-12 education where the Governor proposes $4 billion in additional expenditures to fully fund the Proposition 98 guarantee level driven by additional revenues raised in the Governor's proposed Constitutional amendment. The Governor's budget also includes $2 billion to repay Proposition 1A debt borrowed to repay local governments for property tax borrowed in 2009-10.

General Fund Expenditures
(Dollars in Millions)

Program Area	Revised 2011-12	Proposed 2012-13	Change	% Change
K-12 Education	$34,162	$38,179	$4,017	11.8%
Higher Education	$9,821	$9,377	-$444	-4.5%
Health and Human Services	$26,668	$26,414	-$254	-1.0%
Corrections and Rehabilitation*	$9,039	$8,744	-$295	-3.3%
Business, Transportation and Housing	$679	$558	-$121	-17.8%
Natural Resources	$1,935	$1,896	-$39	-2.0%
Environmental Protection	$51	$47	-$4	-7.8%
State and Consumer Services	$619	$689	$70	11.3%
Labor and Workforce Development	$354	$448	$94	26.6%
General Government				
Non-Agency Departments	$450	$514	$64	14.2%
Tax Relief / Local Government	$544	$2,534	$1,990	365.8%
Statewide Expenditures	$840	$553	-$287	-34.2%
Legislative, Judicial and Executive	$2,540	$2,600	$60	2.4%
Total	**$86,512**	**$92,553**	**$6,041**	**7.0%**

**The revised 2011-12 figure is adjusted for a one-time technical reimbursement related to the 2011 Public Safety Realignment.*

PROPOSED BUDGET SOLUTIONS:

The Governor has proposed budget solutions that total approximately $10.3 billion over the two-year period ending with June 30, 2013. The budget balancing proposals are shared between expenditure reductions ($4.2 billion), temporary taxes ($4.4 billion), and other solutions ($1.6 billion). Most of the expenditure solutions are permanent and if adopted would not only address the current budget problem but would also help to address the out-year operating deficits. Most of the revenue solutions are temporary and expire after five years. The table below summarizes the different categories of solutions included in the Governor's budget.

Proposed Budget Solutions
By Category
2012-13
(Dollars in Millions)

Category	2012-13
Expenditure Reductions	$4,216
Revenues	4,651
Other	1,432
Total	**$10,299**

Expenditure Reductions

Expenditure reductions represent about 41 percent of the overall budget solutions at $4.2 billion. General Fund expenditure reductions are discussed in more detail later in this summary, but the following are some of the most significant proposals:

- $946 million reduction to the California Work Opportunities and Responsibility to Kids Program (CalWORKS), including a significant redesign of the program.
- $842 million in cuts to the Medi-Cal program mainly from a proposal to enroll more seniors and disabled Medi-Cal recipients in managed care and a one-time payment deferral.
- $163 million in cuts to the In-Home Supportive Services program.
- $544 million from K-14 education by applying a consistent approach to accounting for the various programmatic adjustments made to the Proposition 98 guarantee over the last several years.
- $447 million in child care reductions.
- $301 million in Cal-Grant program reductions.
- $828 million in savings from suspension or repeal of state mandates on local governments.

Revenues – Constitutional Amendment – New Trigger Cuts

Revenues make up approximately 45 percent of the overall solution. Nearly all of the revenues are from the assumed passage of revenues contained in the Governor’s Constitutional Amendment that is currently being circulated for signatures. The voter initiative would raise $6.9 billion in revenues through 2012-13 and the temporary taxes would expire in five years. The additional revenues raised by the initiative would increase the calculation of the Proposition 98 guarantee by $2.5 billion. Therefore, net of the impacts on the Proposition 98 guarantee, revenues would provide $4.4 billion in budget solution. The Constitutional Amendment would temporarily raise the following taxes for five years:

- **Temporary Personal Income Tax Rates on Highest Income Californians**. The Governor's initiative would add three additional tax brackets. For single filers with income between $250,000 and $300,000 and joint filers with income between $500,000 and $600,000 an additional 1 percent would be applied to income above $250,000 and $500,000, respectively. Income between $300,000 and $500,000 for single filers and income between $600,000 and $1,000,000 for joint filers would be assessed an additional 1.5 percent. Finally, income over $500,000 for single filers and income over $1,000,000 for joint filers would be assessed an additional 2 percent. These changes are expected to raise $5.8 billion in revenues in the current and budget years combined.

- **Temporary Sales Tax Rate Increase of 0.5 percent**. The Governor's initiative would also temporarily raise the sales tax rate by 0.5 percent. This portion of the initiative is expected to generate $1.2 billion in additional revenues in the budget year.

The temporary taxes listed above are necessary to prevent deeper cuts to schools, protect local public safety funding, and assist in balancing the budget. The revenues will allow the state to invest in higher education and to pay off the $33 billion in outstanding budgetary borrowing and deferrals by 2015-16. However, because the voters will not make the ultimate decision until after the budget is approved a backup plan is needed to finance the budget if the revenues are not passed by the voters.

New Trigger Cuts if Ballot Measure Fails. The Governor has put forward a plan that specifies $5.4 billion in trigger cuts affecting education and public safety. The ballot trigger cuts, summarized below, would go into effect on January 1, 2013:

2012-13 Trigger Cuts

Program/Area Reduced	Cut Amount (in millions)
K-14 Schools - funding for schools and community colleges would be reduced by $4.8 billion, which could result in a funding decrease that is equivalent to the cost of three weeks of instruction. It would also continue to provide 20 percent of program funds a year in arrears.	$4,837
University of California and California State Universities.	$400
Courts - the cut could result in closures three days per month.	$125
Department of Forestry and Fire Protection - the emergency air response program would be reduced and fire stations would be closed.	$15
Department of Water Resources - cuts to the flood control program.	$7
Parks and Recreation / Fish and Game - the number of the State's public safety officers in each department would be reduced and the state would no longer staff its beaches with lifeguards.	$6
Department of Justice.	$1
TOTAL	**$5,390**

Other Solutions

The final category of "other" budget solutions total $1.4 billion or 14 percent of the overall solution. The following are the most significant proposals:

- $631 million from extending loan repayments to various special funds borrowed in previous budget years.
- $417 million from using a loan from the Unemployment Compensation Disability Fund to make interest payments to the federal government for Unemployment Insurance (UI) benefits. A new employer surcharge would generate revenue to pay future interest payments and the borrowed funds from the Disability Fund.
- $350 million from additional weight fee revenues.

Public Safety Realignment

BACKGROUND:

The final budget package of 2011 included a major realignment of funding and public safety programs from the State to local governments. The final realignment package dedicated $5.5 billion in existing state revenues to fully fund the public safety realignment. The funding included in the final budget package to support realignment is as follows:

- Redefines 1.06 percent of the existing state sales tax as a local revenue to support $5.1 billion in public safety programs.
- Redirects vehicle license fee (VLF) revenues from the following sources to support public safety programs: (1) $300 million from the Department of Motor Vehicles; (2) $106 million from cities; and (3) $48 million from Orange County

The public safety programs realigned include an array of programs. Most of the programs realigned were already managed and run by the counties with state funds (for example, Child Welfare Services). However, Chapter 15, Statutes of 2011 (commonly referred to as AB 109), did make changes that will move approximately 30,000 nonviolent, non-serious, non-sex offenders that would have been handled by the state prison system to local corrections systems. This change will require expansion of the local public safety system to accommodate these offenders that are no longer being sent to state prison. This bill also gave counties authority over the post-custody supervision for certain offenders after their release from state prison.

The public safety programs realigned, and the funding allocated to each program, are listed on the next page.

Public safety realignment ultimately will enable the State to save $1.5 billion in state prison costs when fully implemented. Furthermore, realignment will enable the state to meet the order set out by the 2011 U.S. Supreme Court decision that affirmed the lower court's decision to require the reduction of overcrowding in the state prison system. The State has two years to reduce the prison population by over 30,000 inmates. Realignment will allow the state to accomplish this reduction in a way that improves public safety by providing additional funding for local support services, rehabilitation programs, and law enforcement that enhance the safety of communities.

Realignment can produce better program outcomes and save money to the extent that counties are given flexibility to fine-tune programs to meet specific local needs and priorities. Realignment should also result in additional savings to state operations related to these realigned programs as the state fine tunes and in some cases minimizes its role in implementing services being managed by the counties.

Realignment Funding (Dollars in Millions) – Updated January 2012 Budget Plan

Program	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Court Security	$496.4	$496.4	$496.4	$496.4
Vehicle License Fee Public Safety Programs	489.9	489.9	489.9	489.9
Local Jurisdiction of Lower-level Offenders and Parole Violators				
Local Costs	239.9	581.1	759.0	762.2
Reimbursement of State Costs	957.0	0.0	0.0	0.0
Realign Adult Parole				
Local Costs	127.1	276.4	257.0	187.7
Reimbursement of State Costs	262.6	0.0	0.0	0.0
Mental Health Services				
EPSDT	0.0	544.0	544.0	544.0
Mental Health Managed Care	0.0	188.8	188.8	188.8
Existing Community Mental Health Programs	1,104.8	1,164.4	1,164.4	1,164.4
Substance Abuse Treatment	179.7	179.7	179.7	179.7
Foster Care and Child Welfare Services	1,562.1	1,562.1	1,562.1	1,562.1
Adult Protective Services	54.6	54.6	54.6	54.6
Existing Juvenile Justice Realignment	95.0	98.8	100.4	101.3
Program Cost Growth*	0.0	180.1	443.6	988.8
Total	**$5,569.1**	**$5,816.3**	**$6,239.9**	**$6,719.9**
VLF Funds Available	**$462.1**	**$496.3**	**$491.9**	**$491.9**
1.0625% Sales Tax	**$5,107.0**	**$5,320.0**	**$5,748.0**	**$6,228.0**

*This amount will be subject to future legislation and is intended to cover county costs and reimburse reasonable state costs.

GOVERNOR'S 2012-13 BUDGET PROPOSAL:

Governor Proposes Constitutional Protection for 2011 Realignment. The Constitutional amendment proposed by the Governor contains Constitutional protection for the revenue dedicated to 2011 Realignment. This initiative will protect local governments against future costs imposed upon them, as well as provide mandate protection for the state.

Governor Proposes Ongoing Funding Structure for 2011 Realignment. Although the revenue stream for the 2011 realignment enacted last year is ongoing, the program allocations were for the 2011-12 fiscal year only. The Governor, in consultation with the California State Association of Counties (CSAC), has proposed a permanent funding structure for 2011 Realignment for both the base and growth funding. The funding structure was designed with the overall goal of providing a known, reliable, and stable funding source for the programs realigned. The structure would establish the following two accounts in the County Local Revenue Fund: (1) Support Services Account and (2) Law Enforcement Services Account.

The Support Services Account will contain two Subaccounts:
- Protective Services Subaccount will contain funding for Foster Care; Child Welfare Services; Adoptions; Adoptions Assistance Program; Child Abuse Prevention, Intervention, and Treatment; and Adult Protective Services.
- Behavioral Health Subaccount will contain funding for Drug Medi-Cal; Drug Courts; Perinatal Drug Services; Non-Drug Medi-Cal Services; Mental Health Managed Care; and Early and Periodic Screening, Diagnosis, and Treatment.

The Law Enforcement Services Account will contain five subaccounts:
- Trial Court Security Subaccount.
- Law Enforcement Services Subaccount.
- Community Corrections Subaccount.
- District Attorney/Public Defender Subaccount.
- Juvenile Justice Subaccount, containing both the Youthful Offender Block Grant and Juvenile Reentry Fund.

The Governor proposes to allocate program growth on roughly a proportional basis first among the Accounts and then among the Subaccounts. Within each subaccount, federally required programs would receive priority funding if warranted by caseload and costs. Furthermore, the Governor has proposed that growth funding for the Child Welfare Services program be a priority once base programs are established and should receive $200 million in additional growth funds over time. This is partially in recognition of a significant cut that was sustained to Child Welfare Services programs in 2010.

The Governor has also proposed some flexibility for the counties to move money among subaccounts. Specifically, the Governor has proposed that counties have the ability to transfer up to 10 percent between subaccounts within the Support Services Account. This is modeled after similar flexibilities provided in the 1991 Realignment. Furthermore, the Governor has also proposed a local option to transfer a portion of growth among subaccounts within the Law

Enforcement Services Account beginning in 2015-16. These transfers would only be valid for one year and would not increase the base of any program.

Governor Proposes Next Steps on Realignment. Last year the Governor discussed a broad phase 2 realignment plan involving significant changes in health and human services programs. This year the Governor's budget seems to slow down the implementation of a phase 2 realignment plan and instead focuses on implementing the 2011 Public Safety Realignment. The Governor continues to be committed to a 25 percent reduction in state operations of programs realigned to the counties in 2011. The Governor is also proposing to continue training efforts related to implementing the Community Corrections Partnerships by providing $8.9 million for a second year of training efforts.

The Governor is proposing new realignment efforts in the area of education reform and has proposed significant changes to current funding formulas for aid to local schools. These changes include a weighted pupil funding formula to be phased in over the next five years. The Governor's proposal generally centralizes more control over school funding allocations with local school districts. These proposals are discussed in the education section of this report.

The Governor is also proposing to continue the realignment of the juvenile justice system that started 15 years ago by stopping intake of juveniles to state facilities by January 1, 2013, providing $10 million General Fund to counties to begin planning for this population, and to delay collection of the recently imposed fees for wards housed in the state Division of Juvenile Justice facilities. This proposal is discussed further in the public safety section of this report.

The Governor has indicated that phase 2 of realignment will likely center around the implementation of federal health care reform, but that additional data are needed to inform decisions before further plans are made.

ISSUES TO CONSIDER:

Dedicated long term funding and Constitutional protections for both the counties and State are critical. Last year realignment was funded through the redirection of existing state revenues. The funds were excluded from the Proposition 98 calculation in the current year. However, absent additional revenues, current law would require that the Proposition 98 guarantee be backfilled over a five-year period for the loss of realignment-related sales taxes in 2011-12 and be recalculated in future years to include these taxes. The budgetary pressures resulting from this recalculation would jeopardize funding for realignment and other programs in the state budget. The Governor has proposed a Constitutional Amendment that would generate $6.9 billion in additional revenues that would address the schools funding issues. This Constitutional Amendment would also provide counties with a constitutional guarantee to the realignment funding and provide the State with protections against counties filing mandate claims related to realignment. Absent a Constitutional Amendment, significant additional actions would need to be taken to balance the state's budget.

The Public Safety Realignment implemented in 2011 was a major programmatic change and it will take years of fine-tuning and adjustments. In the 1990s, during the last major realignment of programs that occurred between the state and the counties, there was years of legislation and administrative changes that followed the actual realignment legislation. There is no reason to expect that this time around will be any different. This iterative process will allow us to observe and learn from actual experience about items that may need changed or unintended consequences that need to be avoided.

Counties have been working on their Community Corrections Plans to implement and expand programs to accommodate the additional offenders no longer eligible for state prison or state supervision under AB 109. This portion of realignment has required the hiring of new personnel, the development of additional community programs, and in some cases planning long-term capital investments in infrastructure. However, for many of the programs realigned, there have been far fewer impacts and changes (Substance Abuse Programs, Foster Care and Child Welfare Services, Mental Health, and Adult Protective Services). This is mainly because counties had primary responsibility for implementing these programs prior to realignment. However, as we review realignment, we may want to determine if additional changes are warranted to improve delivery of service and program outcomes.

Fiscal incentives are important in the allocation of realignment revenues among counties. Current law only specifies allocation of realignment revenues through the current fiscal year. Therefore, a long-term methodology for allocating realignment revenues will be needed going forward. The Governor continues to work with the California State Association of Counties (CSAC) on an allocation methodology.

The Legislature may wish to consider the fiscal incentives inherent in the funding allocation methodology to ensure that counties are investing in best practices that result in good program outcomes. There continues to be considerable risk for the State if the counties have poor program outcomes. For example, the state will continue to have some fiscal responsibility for a county's failure to meet federal child welfare guidelines and criminal offenders with underlying disorders (mental health and substance abuse) that are left untreated will be more likely to end up in state prison at the state's cost.

The overall funding structure provides some flexibility for counties. Last year an overall funding structure for the counties was deferred and most existing funding streams were allocated virtually the same way they had been allocated the previous year. The exception to that was the new funding provided for the implementation of AB 109. This year the Governor has come forward with a permanent funding structure that provides counties with some flexibility to move funding among subaccounts. The Legislature may wish to consider whether more flexibility be provided, especially among some of the subaccounts in the Law Enforcement Services Account earlier than 2015-16 as proposed by the Governor. In addition, the Legislature may also wish to evaluate other options for providing flexibility for counties by evaluating laws and regulations that can be changed to enhance program outcomes and state oversight.

The State's oversight and administrative infrastructure still needs retooled. The Governor has indicated that he continues to be dedicated to reducing state administration related to the realigned programs by 25 percent. The Governor reduced the Department of Alcohol and Drug Programs and Mental Health by 25 percent before their functions were transferred to the Department of Health Care Services. The Governor indicates that the Department of Social Services will develop its 25 percent reduction plan in the coming year in consultation with the federal government and counties. This is especially important given the continued role of the State, per federal dictate, in the oversight of the Foster Care and Child Welfare System.

Reorganizing State Government

GOVERNOR'S PROPOSAL:

The Governor's Budget includes major proposals to reorganize state government. The proposal would reduce the number of agencies from 12 to 10, eliminate 39 state entities, and eliminate 9 programs. In most cases, these proposals are not reflected in the 2012-13 budget detail – the existing entities are reflected for purposes of scheduling expenditures in the budget bill. If some or all of these proposals were approved by the Legislature, implementation would likely occur over time.

It should be noted that last year, the Legislature approved the elimination of 23 boards and commissions, and various program reductions totaling $24.6 million in savings. Some of the Governor's proposals this year are the same as those proposed last year but not adopted.

In addition to reorganization, the Governor proposes to improve efficiency in the budget process by zero-basing some departments and providing for a special focus on program goals and outcomes. The Governor indicates some departments, including the Department of Transportation and the Department of Consumer Affairs, will be directed to perform a detailed review and analysis of all their programs to evaluate whether the functions need to exist and the level of resources needed to accomplish them. Pursuant to Executive Order B-13-11, the Director of Finance will create a plan by March 2012 for modifying the budget process to increase efficiency and focus on accomplishing program goals.

Business, Transportation and Housing

- **Transportation Agency** – The governor's budget proposes separating the transportation component and placing it into a separate agency that would be responsible for Caltrans, DMV, High-Speed Rail, California Highway Patrol, and the Board of Pilot Commissioners.
- **Office of Traffic Safety –** The governor's budget proposes the elimination of the Office of Traffic Safety and transferring its functions to the Department of Motor Vehicles.
- **California Housing Finance Agency** – The governor's budget proposes to fold the operations of the California Housing Finance Agency into the Department of Housing and Community Development.
- **Department of Business Oversight –** The governor's budget proposes to eliminate both the Department of Financial Institutions and the Department of Corporations and transfer their functions to the proposed Department of Business Oversight.

State and Consumer Services

- **Business and Consumer Services Agency** – The governor's budget proposes to create a new Agency that will incorporate the remaining functions of the Business, Transportation, and Housing Agency (see Transportation Agency above) into an agency that will include the departments of Consumer Affairs, Housing and Community Development, Fair Employment and Housing, Alcohol and Beverage Control and the newly-proposed Business Oversight department.

- **Department of Real Estate –** The governor's budget proposes to eliminate the Department of Real Estate and transfer the entity into the Department of Consumer Affairs where it will function as a bureau.
- **Office of Real Estate Appraisers –** The governor's budget proposes to eliminate the Office of Real Estate Appraisers and transfer the entity into the Department of Consumer Affairs where it will function as a bureau.
- **Board of Chiropractic Examiners –** The governor's budget proposes to convert the board into a bureau within the Department of Consumer Affairs.
- **Governor's Mentorship Program** - The governor's budget proposes to eliminate this program.
- **Fair Employment and Housing Commission** – This proposal transfers the Commission's adjudicatory and regulatory functions to the Department of Fair Employment and Housing. Adjudication of employment and housing discrimination cases will be handled by a separate division within the Department of Fair Employment and Housing.
- **Structural Pest Control Board** – This budget proposes to eliminate the board and turn it into a bureau within the Department of Consumer Services.

<u>General Government</u>

- **Government Operations Agency –** The governor's budget proposes to integrate major components of state administration, including procurement, information technology, and human resources into one single entity. This new agency will include the departments of General Services, Human Resources, Technology, the Office of Administrative Law, the Public Employees' Retirement System, the State Teachers' Retirement System, and the newly restructured Department of Revenue. It also will include the State Personnel Board and the Government Claims Board.
- **Commission on the Status of Women** – The governor's budget proposes to eliminate the Commission on the Status of Women.
- **Office of Privacy Protection –** The governor's budget proposes to eliminate the Office of Privacy Protection.
- **State 9-1-1 Advisory Board –** The governor's budget proposes to eliminate the State 9-1-1 Advisory Board.
- **Technology Services Board** – The governor's budget proposes to eliminate the Technology Services Board.
- **Electronic Funds Transfer Task Force –** The governor's budget proposes to eliminate the Electronic Funds Transfer Task Force.
- **Department of Revenue –** The governor's budget includes a proposal to consolidate the tax functions of the Employment Development Division with the Franchise Tax Board.

- **Governor's Emergency Operations Executive Council –** The governor's budget includes a proposal to eliminate the council.
- **Governor's Office of Business and Economic Development –** This proposal transfers the Infrastructure Bank, the Film and Tourism Commissions, the Small Business Centers, and the Small Business Guarantee Loan Program into the Governor's Office of Business and Economic Development.

<u>Legislative, Judicial and Executive</u>

- **California Emergency Management Agency –** The governor's proposal would eliminate the California Emergency Management Agency and transfer its functions to the governor's office.
- **California Law Revision Commission –** This proposal would eliminate the commission and consolidate its functions within the legislative counsel bureau.
- **Commission on Uniform State Laws –** This proposal would eliminate the commission and consolidate its functions within the legislative counsel bureau.
- **Governor's Mentorship Program –** This proposal would eliminate the Governor's Mentorship Program.
- **California Volunteer Agency –** This proposal would eliminate the California Volunteer Agency and transfer its functions to the Governor's Office of Planning and Research.
- **Gambling Control Commission –** This proposal would consolidate many of commission's functions within the Department of Justice.

<u>Education</u>

- **Vocational Education Summer Leadership Programs –** This proposal would eliminate the leadership development program for vocational student officers, instructional materials for vocational teacher advisors, and training and preparation for new vocational education teachers.
- **Eliminate Non-Proposition 98 General Fund for Indian Education Centers –** This proposal would eliminate funding for a program that provides funding to support local educational resources for American Indian students, parents, and public schools in American Indian communities.
- **California State Summer School for the Arts with the California Arts Council –** This proposal would consolidate the functions of the California Arts Council with the California State Summer School for the Arts.

<u>Labor</u>

- **Occupational Health and Safety Standards Board –** This proposal would eliminate the Occupational Health and Safety Standards Board and transfer its responsibilies to the Division of Occupational Safety and Health within the Department of Industrial Relations.

- **Division of Labor Statistics and Research –** This proposal would eliminate the Division of Labor Statistics and Research and transfer its functions related to maintaining job safety records, reports, and statistics to the Division of Occupational Safety and Health.

Health

- **Department of Mental Health –** This proposal would eliminate the Department of Mental Health and transfer its functions to the departments of Health Care Services, Public Health, Social Services, Education, the Office of Statewide Health Planning and Development, and the Mental Health Services Oversight and Accountability Commission.
- **Department of Alcohol and Drug Programs –** This proposal would eliminate the Department of Alcohol and Drug Programs and transfer its functions to the Departments of Health Care Services, Public Health, and Social Services.
- **Managed Risk Medical Insurance Board** – This proposal would eliminate the Managed Risk Medical Insurance Board and transfer its functions to the Department of Health Care Services.
- **Rehabilitation Appeals Board –** This proposal would eliminate the Rehabilitation Appeals Board and shift its duties to independent hearing offices.
- **Office of Health Equity –** This proposal would consolidate the Department of Health Care Services' Office of Women's Health; the Department of Public Health's Office of Multicultural Health; Health in All Policies Task Force; the Health Places Team; and the Department of Mental Health's Office of MultiCultural Services into one office; the Office of Health Equity.

Environmental Protection

- **Department of Resources Recycling and Recovery (CalRecycle) –** This proposal would transfer the functions of the department to the California Environmental Protection Agency.
- **Regional Water Boards –** This proposal would reduce the number of regional water boards to a total of eight by realigning current boundaries.
- **Department of Toxic Substances Control –** This proposal would eliminate underutilized programs within the department. The following programs are proposed for elimination: Expedited Remedial Action Program, Private Site Management Program, California Land Environmental Restoration and Reuse Act Program, Hazardous Waste and Border Zone Property Designations, Abandoned Site Assessment Program, and the Registered Environmental Assessor Program.

Natural Resources

- **Watershed Coordinator Initiative Program –** This proposal would eliminate the Watershed Coordinator Program.
- **Colorado River Board –** This proposal would eliminate the Colorado River Board and consolidate its functions within the Natural Resources Agency.

- **State Geology and Mining Board –** This proposal would transfer the board's appeals process to the Office of Administrative Hearings and the rest of the board's responsibilities to the Office of Mine Reclamation within the Department of Conservation.
- **Department of Fish and Game –** The governor's budget proposes to eliminate six advisory groups within the Department of Fish and Game – the Salton Sea Restoration Council, the California Advisory Council on Salmon and Steelhead Trout, the Commercial Salmon Review Board, the State Interagency Oil Spill Committee, the State Interagency Oil Spill Review Subcommittee, and the Abalone Advisory Committee.
- **Department of Boating and Waterways –** This proposal would eliminate the Department of Boating and Waterways and transfer its functions into the Department of Parks and Recreation.

ISSUES TO CONSIDER:

As part of the 2011 budget, the Legislature eliminated 23 boards and commissions. In evaluating this year's proposals, the Legislature will review the amount of budget savings that would be generated from each elimination or consolidation, and understand if those governmental services will be diminished, or just made more efficient. If services are diminished or eliminated, the Legislature will have to determine if it agrees with the Administration's priorities for limited budget dollars. One factor to consider is if there is overlap in the provision of these services with the federal government, local governments, or non-profit organizations. In some cases, no savings are indicated, and the Administration should be prepared to explain the non-fiscal benefits of the proposals.

SUBCOMMITTEE NO. 1

EDUCATION

Proposition 98 & K-12 Funding

BACKGROUND:

This paper presents the major components of the Governor's 2012-13 Proposition 98 budget package. The following sections provide background on Proposition 98, summarize the Governor's proposed Proposition 98 funding levels and expenditure plans for K-12 schools and community colleges, and identify issues for the Legislature to consider in evaluating the Governor's proposals.

Proposition 98 Initiative and Funding History. State funding for K–14 education – primarily K-12 local educational agencies and community colleges - is governed largely by Proposition 98, passed by voters in 1988. The measure, modified by Proposition 111 in 1990, establishes minimum funding requirements – referred to as the "minimum guarantee" – for K-14 education. Until recently, Proposition 98 supported most state funding for child care programs. In 2011-12, child care funding was shifted out of Proposition 98; however, Proposition 98 funding was continued for the state's subsidized part-day preschool program.

The table below summarizes overall Proposition 98 funding for K-12 schools and community colleges since 2007-08, before the state economy and state General Fund revenues began to fall resulting in significant budget reductions for education K-14 education, as well as other state funded programs.

Proposition 98 Funding (Dollars in Millions)	2007-08	2008-09	2009-10	2010-11	2011-12 Budget Act	2011-12 Revised	2012-13 Proposed
K-12 Education							
General Fund	$37,752	$30,075	$31,472	$31,291	$29,328	$29,329	$33,755
Local property tax revenue	12,592	12,969	12,631	12,084	13,823	12,891	12,908
K-12 Subtotal	**$50,344**	**$43,044**	**$44,103**	**$43,376**	**$43,151**	**$42,220**	**$46,663**
California Community Colleges							
General Fund	$4,142	$3,918	$3,721	$3,885	$3,466	$3,217	$3,683
Local property tax revenue	1,971	2,029	1,993	1,959	1,949	2,107	2,101
CCC Subtotal	**$6,112**	**$5,947**	**$5,714**	**$5,844**	**$5,415**	**$5,324**	**$5,784**
Other Agencies	**$121**	**$105**	**$93**	**$87**	**$85**	**$83**	**$80**
Total Proposition 98	**$56,577**	**$49,096**	**$49,910**	**$49,306**	**$48,651**	**$47,627**	**$52,527**
General Fund	**$42,015**	**$34,098**	**$35,286**	**$35,263**	**$32,879**	**$32,629**	**$37,518**
Local property tax revenue	**$14,563**	**$14,997**	**$14,624**	**$14,044**	**$15,772**	**$14,998**	**$15,009**

Source: Legislative Analyst's Office

Calculating the Minimum Guarantee. The Proposition 98 minimum guarantee is determined by one of three formulas (tests) set forth in the State Constitution. The operative test for each fiscal year is determined according to various economic and fiscal factors. These factors include measures of state personal income, General Fund revenues, and student enrollment, as follows:

- **Test 1 -- Percent of General Fund Revenues.** Test 1 is based on a percentage or share of General Fund tax revenues. The base year for the Test 1 percentage is 1986−87 -- a year in which K-14 education received approximately 40 percent of General Fund tax revenues. As a result of the recent shifts in property taxes from education to cities, counties, and special districts, the current rate is approximately 39 percent.

- **Test 2 -- Adjustments Based on Statewide Personal Income.** Test 2 is operative in years with normal to strong General Fund revenue growth. This calculation requires that school districts and community colleges receive at least the same amount of combined state aid and local property tax dollars as they received in the prior year, adjusted for enrollment growth and growth in per capita personal income.

- **Test 3 -- Adjustment Based on Available Revenues.** Test 3 is used in low revenue years when General Fund revenues decline or grow slowly. During such years, the funding guarantee is adjusted according to available resources. A "low revenue year" is defined as one in which General Fund revenue growth per capita lags behind per capita personal income growth more than one−half percentage point.

Suspension of Minimum Guarantee. Proposition 98 includes a provision allowing the Legislature to suspend the minimum funding requirements. In so doing, the Legislature can provide an alternative level of funding to that required by the Proposition 98 formulas. In order to suspend, the Legislature must pass an urgency bill – other than the budget bill – requiring a two-thirds vote for passage. To date, the Legislature has voted to suspend the Proposition 98 minimum guarantee twice -- in 2004-05 and 2010-11.

Maintenance Factor. In years following a suspension of the minimum guarantee or a Test 3 year, (when the Proposition 98 guarantee grows more slowly due to declining or low General Fund growth), the state creates an out–year obligation referred to as a "maintenance factor." When growth in state General Fund revenues is healthier (as determined by a specific formula also set forth in the Constitution), the state is required to make maintenance factor payments, thereby accelerating growth in K–14 funding, until the maintenance factor obligation is fully restored.

Settle-Up. Another type of Proposition 98 obligation is created when the finalized calculation of the minimum guarantee for a particular year ends up being higher than the Proposition 98 appropriation for that year. When this happens, the state needs to make a "settle–up payment" (or series of payments) to ensure the minimum guarantee is met.

GOVERNOR'S PROPOSAL:

Proposition 98 – Overall Funding Levels for K-14 Education

2011-12 Revisions. The Governor's proposed revisions provide **$47.6 billion** in Proposition 98 funding in 2011-12. This is roughly $1.0 billion below the level of funding authorized in the 2011 Budget Act, reflecting reductions of $436 million in December trigger cuts and more than $588 million in savings from lower than estimated student growth funding. Since the estimated minimum guarantee drops by $360 million below 2011-12 budget levels, the Governor proposes **$661 million** in future settle-up payments to meet the revised minimum guarantee in 2011-12. This level of funding reflects new revenues for K-14 education from the Governor's proposed

November 2012 tax initiative. The Administration assumes that 2011-12 will continue to be a Proposition 98 Test 1 year.

Proposition 98 Funding (Dollars in Millions)	**2011-12 Revised**	**2012-13 Proposed**	**Change from 2011-12 Amount**	**Percent**
K-12 education				
General Fund	$29,329	$33,755	$4,426	15%
Local property tax revenue	12,891	12,908	17	0%
Subtotals	$42,220	$46,663	4,443	11%
Community Colleges				
General Fund	$3,217	$3,683	465	14%
Local property tax revenue	2,107	2,101	-6	0%
Subtotals	5,324	5,784	459	9%
Other Agencies				
General Fund	83	80	-2	-3%
Totals	**$47,627**	**$52,527**	**$4,900**	**10%**
General Fund	$32,629	$37,518	$4,889	15%
Local property tax revenue	$14,998	$15,009	$11	0%

2012-13 Proposals. The Governor's Budget provides Proposition 98 funding of **$52.5 billion** for K-12 education in 2012-13, an increase of $4.9 billion compared to 2011-12, as revised. This level of funding assumes passage of the Governor's 2012 tax initiative, which per the Administration would produce an additional $2.5 billion in new funds for education in 2012-13. The Administration estimates that Proposition 98 will be a Test 1 year in 2012-13.

The Governor proposes to expend the additional $4.9 billion in funds principally to reverse $2.2 billion in costs for the new inter-year payment deferrals in 2011-12 and to reduce ongoing payments deferrals in 2012-13 for K-12 schools and community colleges by $2.4 billion.

Proposition 98 Trigger Cuts

2012-13 Trigger Cuts. In the event his 2012 tax initiative does not pass, the Governor has an alternative Proposition 98 budget plan for 2012-13. Under the Governor's alternative plan, Proposition 98 guarantee would fall to approximately **$50.3 billion** in 2012-13 and approximately $4.8 billion in Proposition 98 funding reductions would be "triggered" mid-year for K-14 education. These reductions reflect a $2.4 billion drop in the minimum guarantee from lower revenues. In addition, the Governor proposes to shift K-14 general obligation bond debt service payments into the lower minimum guarantee, accompanied by $2.4 billion in Proposition 98 program reductions to accommodate this shift.

In order to achieve the $4.8 billion in Proposition 98 reductions in 2012-13, the Governor proposes to: (1) eliminate the restoration of $2.4 billion in inter-year payment deferrals currently proposed by the Governor; and (2) implement an additional $2.4 billion in unspecified, proportional programmatic reductions for K-14 education. The table displays the specific reductions for K-12 and community colleges included in the Governor's mid-year trigger cuts.

Governor's 2012-12 Trigger Cuts (Dollars In Billions)	**K-12 Schools**	**Community Colleges**	**Total**
Eliminating Buy Down of Payment Deferrals	$2.2	$.2	$2.4
Unspecified Programmatic Cuts	2.2	.2	2.4
Total	**$4.4**	**$.4**	**$4.8**

The Administration plans to work with K-12 schools and community college officials and stakeholders to develop legislation regarding the unspecified programmatic reductions with intent to protect education programs and allow the education systems to develop and implement necessary contingency plans. According to the Department of Finance, a $2.2 billion reduction equates to roughly $370 per student, or approximately three weeks of school.

Governor's Major Budget Adjustments. The Governor's Proposition 98 budget proposal reflects a variety of factors – new revenues and various rebenching adjustments -- that change the minimum guarantee in 2011-12 and 2012-13. All together, these adjustments have the effect of increasing the Proposition 98 minimum guarantee by **$2.3 billion** in 2012-13. These adjustments are listed and described below.

- **Revenue Adjustments.** The Governor assumes the following changes in revenues that affect calculation of the Proposition 98 minimum guarantee.

  - **New Revenues from the Governor's Tax Initiative.** As proposed, the Governor's November 2012 tax initiative would raise $6.9 billion in new revenues that would be directed to the Education Protection Account. The Governor budgets these revenues on an accrual basis, which attributes $2.2 billion to 2011-12 and $4.7 billion to 2012-13. While these revenues are partially offsetting to Proposition 98, the Governor estimates that the Proposition 98 minimum funding guarantee will grow by **$879 million** in 2011-12 and **$2.4 billion** in 2012-13 as a result of these new revenues.

- **Rebenching Adjustments.** In addition to assuming new revenues, the Governor's Budget includes a series of adjustments to rebench the Proposition 98 guarantee to reflect tax shifts and programmatic shifts. Several of the Governor's proposed changes involve application of a 1986-87 level cost methodology – used to rebench in the past -- in order to provide a single, consistent methodology for all rebenching adjustments. Individual adjustments are summarized below:

  - **Fuel Tax Swap. The 2011-12 budget act increased the minimum funding guarantee by $578 million** to reflect current laws that hold Proposition 98 harmless from the loss of revenues from the fuel tax swap that began in 2010-11**.** Trailer bills in 2011-12 extended previous laws that assured no negative effect from the amounts that would otherwise be calculated for the tax change under Test 1 of the Proposition 98 minimum funding guarantee. The Governor's 2012-13 budget proposes to eliminate these policies enacted to hold Proposition 98 harmless from the elimination of the state's share of sales tax on gasoline. This adjustment would reduce the minimum guarantee by **$596 million** beginning in 2011-12.

- **RDA Related Property Taxes.** The 2011-12 budget required redevelopment agencies (RDAs) to make **$1.7 billion** in remittance payments to K-12 local education agencies pursuant to 2011-12 budget trailer bills. As enacted, these budget measures required that new local funds be used to offset state General Fund support of Proposition 98 through a rebenching of the Test 1 factor. A recent California Supreme Court decision on last year's legislation resulted in the elimination of RDAs and a different allocation of related property tax revenue to schools and community colleges. Due to the court decision, estimated revenues for schools and community colleges have dropped from $1.7 billion to $1.1 billion in 2011-12. The Governor's Budget proposes to continue **$1.1 billion** in offsetting local property taxes in 2012-13 due to the elimination of RDAs. In so doing, the Governor proposes to rebench this adjustment based upon 1986-87 property taxes. This adjustment increases the minimum guarantee by **$267 million**.
- **Child Care Funding Shift.** The 2011-12 budget provided a decrease in the minimum guarantee of **$1.134 billion** to reflect the shift of funding for most child care programs from Proposition 98 General Fund to non-98 General Fund. The budget continued Proposition 98 funding for part-day preschool programs in 2011-12. The Governor proposes to rebench the 2011-12 funding shift based upon the 1986-87 costs for child care programs. This adjustment increases the minimum guarantee by an additional **$298 million** in 2012-13, compared to the 2011-12 budget act.
- **Mental Health Shift.** The 2011-12 budget act provided an increase of **$221.8 million** in Proposition 98 funding to reflect a shift in responsibility for the provision of educationally related mental health services for students with disabilities from counties to K-12 schools. The minimum guarantee was increased by $221.8 million to cover these services in 2011-12. The Governor proposes to rebench this 2011-12 funding shift based upon the 1986-87 costs for these mental health programs. This change reduces the minimum guarantee by **$197 million** in 2011-12. In addition, the Governor proposes an additional adjustment of **$98.6 million** for special education mental health services in 2012-13 to cover costs funded in 2011-12 out of Proposition 63 funds, ensuring the guarantee is fully adjusted for the program. This change increases the minimum guarantee by **$5 million** in 2012-13.

Major Adjustments -- Governor's Alternative Budget. The Governor proposes the following revenue and rebenching adjustments, if the tax initiative is not passed by voters:

- **Revenue Adjustments.**
  - **Realignment-Related Sales Taxes.** The 2011-12 budget package removed $5.1 billion in sales tax revenues from the Proposition 98 calculation to reflect the redirection of specific state sales tax revenues to local realignment. As a result, these sales tax funds were excluded from the Proposition 98 calculation in 2011-12 and reduced the minimum funding guarantee by **$2.1 billion**. Pursuant to budget trailer bill language contained in AB 114 (Ch. 43; Statutes of 2011), these sales tax exclusion provisions are operative beginning in 2011-12, only if: (1) these changes are authorized via ballot measures prior to November 17, 2012; and (2) new funding is provided for K-12 schools and community

colleges equal to the amount that would have otherwise been provided if specified sales tax revenues were General Fund. If these conditions are not met, sales tax funds that would have been provided to Proposition 98 in 2011-12 prior to this shift would have to be calculated and repaid to K-12 schools and community colleges -- over a five year period beginning in 2012-13. In subsequent fiscal years, these sales tax revenues would be included in the calculation of the minimum guarantee. The Governor's alternative budget includes $450 million in General Fund in 2012-13 to begin repayments to backfill for the $2.1 billion loss of realignment-related sales taxes from Proposition 98 in 2011-12. However, under his alternative budget, the Governor proposes to exclude realignment-related sales taxes from the Proposition 98 minimum guarantee in 2012-13.

- **General Obligation Bond Debt Payments.** The Governor proposes to include K-14 general obligation bond debt-service payments within the Proposition 98 minimum guarantee in 2012-13. The Governor proposes to rebench the guarantee to reflect this shift based upon the 1986-87 costs for these bond payments. This adjustment increases the minimum guarantee by **$200** million in 2012-13. The cost of debt service payments is $2.6 billion. To accommodate the remaining program within the minimum guarantee, the Governor proposes $2.4 billion in unspecified Proposition 98 programmatic reductions.

Governor's Major Proposition 98 Expenditure Proposals. As summarized by the table below, the **$4.9 billion** in additional Proposition 98 funding provided by the Governor's budget plan in 2012-13 would be expended primarily to backfill one-time solutions in 2011-12 -- most notably to cover the costs of the $2.2 billion K-14 payment deferral added in 2011-12 – and to buy-down ongoing K-14 payment deferrals by $2.4 billion in 2012-13.

2012-13 Proposition 98 Spending Changes - Ongoing (Dollars In Millions)	
Technical	
Backfill one-time actions	$ 2,440
Make revenue limit technical adjustments	162
Fund revenue limit growth	158
Backfill Proposition 63 mental health funding	99
Backfill CCC fee revenue decline	97
Make other technical adjustments	-182
Subtotal	**$ 2,775**
Policy	
Pay down K-12 deferrals	$ 2,151
Pay down CCC deferrals	218
Create K-12 mandate block grant	98
Create CCC mandate block grant	12
Do not initiate Transitional Kindergarten program	-224
Reduce preschool funding	-58
Swap one-time funds	-57
Eliminate Early Mental Health Initiative	-15
Subtotal	**$ 2,125**
Total	**$ 4,900**

The Governor's budget does not build back any funding for the school transportation program in 2012-13, which provides savings of **$496 million** in 2012-13. Per the Governor, the 2011-12 trigger cut eliminated remaining funding for the program, and the Governor proposes to continue elimination of the program in 2012-13. (Note: The Legislature passed SB 81 on February 2, 2012, to restore $248 million in trigger cuts for school transportation programs, and instead implement a $248 million reduction in revenue limit apportionments in 2011-12.)

The Governor provides **$158 million** in growth funding for K-12 revenue limit apportionments based upon enrollment growth – as measured by student average daily attendance (ADA) – which is estimated by the Administration to grow by .35 percent in 2012-13. The Governor also provides growth funding for two categorical programs -- **$56.6 million** for Charter Schools and **$12.3 million** for Special Education. The Governor does not provide growth funding for the community colleges in 2012-13. In addition, the Governor does not propose to fund cost-of-living adjustments (COLAs) for K-14 education programs. The COLA rate is estimated at 3.19 percent in 2012-13.

The Governor's proposal adds **$110 million** to expand funding for new block grants for K-12 schools and community colleges to replace the current education mandates program in 2012-13.

The Governor also proposes to reduce several programs, including savings of **$224 million** to halt the creation of a new, two-year state "Transitional" Kindergarten program beginning in 2012-13, pursuant to Chapter 75, Statutes of 2010. In addition, the Governor proposes to cut the state preschool program by $57 million by lowering income eligibility and reducing reimbursement rates in 2012-13. The Governor also proposes to eliminate the Early Mental Health Initiative program, currently administered by the State Department of Mental Health, for a savings of **$15 million** in 2012-13.

Reducing the State's Wall of Debt

The Governor's Budget proposes to pay down the "Wall of Debt" as a means of addressing unprecedented levels of state debts, deferrals, and budgetary obligations. The Governor's Wall of Debt identifies **$33 billion** in outstanding budgetary borrowing statewide. According to the Department of Finance, this includes **$17.4 billion (52.7 percent)** in Proposition 98 related funding obligations for K-12 schools and community colleges.

Governor's Budget -- Outstanding Budgetary Borrowing (Dollars in Billions)	
Deferred payments to K-12 schools and community colleges	$10.4
Unpaid state mandate costs to K-12 schools and community colleges	3.6
Underfunding of Proposition 98:	3.4
-Proposition 98 Settle-Up	(1.9)
-Quality Education Investment Act	(1.1)
-Emergency Repair Program	(0.5)
Total, K-14 Education	**$17.4**
Total, All State Programs	**$33.0**

Similar to the Governor's Wall of Debt, the Legislative Analyst's Office (LAO) has tracked outstanding Proposition 98 obligations in recent years through updates of the "Education Credit Card". Beyond the Governor's list, the LAO also includes obligations to restore revenue limit deficit factors for K-12 schools on the Education Credit Card list. Here's a summary of the Proposition 98 spending obligations identified by the Governor and the LAO to date.

- **K–14 Inter-Year Payment Deferrals**. The 2011-12 budget act continued the state's reliance on ongoing, inter-year payment deferrals to achieve budget solution, deferring an additional $2.1 billion in K–12 payments and $129 million in CCC payments from 2011–12 to 2012–13. As a result, ongoing Proposition 98 payment deferrals total **$10.4 billion** for K-12 schools and community colleges in 2011-12. At this level, 20 percent of the funding for Proposition 98 programs in 2011–12 will not be paid until 2012–13. The Governor proposes to reduce K-14 deferrals by $2.4 billion in 2012-13, which would reduce ongoing, inter-year deferrals to a total of $8.1 billion in 2012-13.

- **K-14 Education Mandate Backlog.** The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. These large unfunded balances resulted in part from the practice of "deferring" annual mandate payments as a means of achieving budget savings. The courts have clarified that K-12 schools and community colleges must fully fund, suspend, or eliminate mandates, so the state can no longer defer mandate payments. The Governor proposes a number of reforms to the K-14 education mandate system beginning in 2012-13.

- **Quality Education Investment Act (QEIA) Payments Remain.** The Governor's budget includes **$450 million** in General Funds to support the QEIA program in 2012-13, which originated with a $2.8 billion Proposition 98 "settlement" agreement in 2006-07. Of this amount, $402 million is provided to schools and $48 million is provided to community colleges. Per statute, the state will be required to make payments through 2014-15 in order to pay off **$1.1 billion** in remaining funds owed per the settlement agreement.

- **Facility Repair Funding Owed.** In 2004, the state settled the *Williams v. California* case, a class–action lawsuit filed on behalf of public school students. In response to the settlement, the Legislature created the Emergency Repair Program (ERP), which provides grants for critical health and safety repairs in certain low–performing schools. Per statute, the state is required to provide a total of $800 million over the life of ERP to meet the requirements of the settlement. The state has appropriated $343 million for the program to date, leaving **$457 million** in remaining funds owed for ERP. In recent years, full funding for the program has been suspended due to budget shortfalls. The Governor proposes **$12.3 million** in one-time Proposition 98 reversion funds for ERP in 2012-13.

- **Revenue Limit Deficit Factor Obligations.** Revenue limits provide the primary form of general purpose (discretionary) funding for K-12 local agencies -- school districts and county offices of education. Revenue limits are funded through both property taxes and state General Fund and allocated on the basis of student enrollment, as measured by average daily attendance (ADA). Funds are continuously appropriated by statutes that continue base funding, adjusted by cost-of-living adjustments (COLAs). In recent years, state funding has been insufficient to fully fund base revenue limits or COLAs. Budget trailer bills have defined statutory deficit factors to reflect base revenue limit reductions and foregone COLAs, and to apply cuts equally to school districts and county offices of education. These deficit factors have been used traditionally to track base revenue limit reductions and foregone COLAs, so that revenue limit levels could eventually be restored. The Governor's Budget reflects deficit factors of 21.666 percent for school districts and 22.497 percent for county offices in 2012-13. It would cost the state approximately **$9.8 billion** to eliminate these deficit factors and fully restore revenue limit base funding and statutory COLAs to K-12 local agencies.

Maintenance Factor Obligations Under Governor's Proposals. The Department of Finance has provided the following information reflecting the level of the Proposition 98 minimum guarantee and maintenance factor under the Governor's budget proposals, including his alternative budget plan.

Proposition 98 Funding (Dollars in Millions)	**2011-12 Revised**	**2012-13 Proposed**	**Alternative Budget** **2011-12 Revised**	**2012-13 Proposed**
State Appropriations Limit (SAL) General Fund Revenues	$85,140	$92,457	$82,891	$87,756
Proposition 98 Minimum Guarantee (State and Local)	48,288	52,527	47,409	50,283
Proposition 98 Guarantee (GF)	32,629	30,881	32,629	35,274
Education Protection Account		6,637		
Local Revenues	14,998	15,009	14,998	15,009
Total Proposition 98 Funded	**$47,627**	**$52,527**	**$47,627**	**$50,283**
Proposition 98 Test	1	1	1	2
Settle Up Created	661			
Settle Up Outstanding	2,569	2,569	1,908	1,908
Maintenance Factor Obligation	10,577	9,739	10,359	10,764
Maintenance Factor Created/Paid (+/-)	--	(1,359)	(218)	(105)

The Governor's budget proposal, which provides **$52.527 billion** Proposition 98 funding in 2012-13 to meet the minimum guarantee, reflects a **$9.739** billion maintenance factor obligation. Due to the new revenues created by the Governor's tax initiative, Proposition 98 formulas require a maintenance factor payment in 2012-13. The Governor proposes to make a **$1.359 billion** maintenance factor payment in 2012-13, which reduces the amount of outstanding maintenance factor owed in 2011-12. The Governor's budget assumes that Test 1 will continue to be the operative test in 2012-13. In calculating the minimum guarantee, the Governor proposes to pay maintenance factor on top of the Proposition 98 Test 1 amount in 2012-13.

Under the Governor's alternative budget, the Proposition 98 funding drops from $52.527 billion to **$50.283 billion** in 2012-13 – a drop of **$2.244 billion**. The Governor's alternative budget assumes that the operative Proposition 98 test will change from Test 1 in 2011-12 to Test 2 in 2012-13. The Governor's alternative budget would provide relatively small maintenance factor payments -- $218 million in 2011-12 and $105 million in 2012-13 – due to the drop in revenues assuming the tax initiative does not pass. These payments result in a small reduction in maintenance factor in 2011-12. However, ongoing maintenance factor would grow to **$10.764**

billion in 2012-13 – even with the small 2012-13 payment – due to changes that result from shifting from a Test 1 to Test 2 calculation.

Programmatic Spending for K-12 Education. The LAO has prepared the table below summarizing total "programmatic funding" for K-12 schools from 2007–08 through 2012-13, including Proposition 98 funds, non-98 General Funds, special funds and federal funds.

Programmatic Funding (Dollars in Millions)	**2007-08 Final**	**2008-09 Final**	**2009-10 Final**	**2010-11 Final**	**2011-12 Revised**	**2012-13 Proposed**	**2012-13 Proposed Alternative**
K-12 ongoing funding[1]	$48,883	$43,215	$40,717	$43,017	$42,254	$46,755	$42,390
Payment deferrals		2,904	1,679	1,719	2,064	-2,151	
Settle-up payments		1,101		267			
Public Transportation Account	99	619					
Freed-up restricted reserves[2]		1,100	1,100				
ARRA funding		1,192	3,575	1,192			
Federal education jobs funding				421	781		
Totals	**$48,982**	**$50,130**	**$47,070**	**$46,616**	**$45,099**	**$44,604**	**$42,390**
Per-Pupil Programmatic Funding							
K-12 attendance	5,947,758	5,957,111	5,933,761	5,953,259	5,947,368	5,950,041	5,950,041
K-12 per pupil funding (Actual Dollars)	**$8,235**	**$8,415**	**$7,933**	**$7,830**	**$7,583**	**$7,496**	**$7,124**

In calculating programmatic funding, the LAO offers a method of reflecting the true level of funding available to K-12 schools for program in a given fiscal year. The utilization of large inter-year payment deferrals to address budget shortfalls and the influx of significant one-time federal education funds to our state has made this less than straightforward, especially for purposes of making year-to-year funding comparisons.

Assuming the Governor's tax initiative is passed by voters, the LAO estimates per pupil programmatic funding would total **$7,496** in 2012-13, a year–over–year reduction of **$87** compared to 2011-12. K-12 schools will receive **$739** less per pupil in programmatic funding in 2012-13 compared to 2007–08.

Under the Governor's alternative plan – assuming the tax initiative fails passage -- per pupil programmatic funding would total **$7,124** in 2012-1. This level of funding would reflect a per pupil decrease of **$459** from 2011-12. Compared to 2007-08, K-12 schools would receive **$1,111** less in per pupil programmatic funding in 2012-13 under the Governor's alternative plan.

[1] Includes ongoing Proposition 98 funding, Proposition 98 accounting adjustments, and funding for the Quality Education Investment Act.
[2] Reflects LAO estimates of federal funds spent in each year.

ISSUES TO CONSIDER:

There are several major issues for the Legislature as it considers the Governor's Proposition 98 budget proposals for 2012-13.

Governor Budget Proposals:

How will revenue changes influence the Governor's Proposition 98 proposals? The LAO estimates lower baseline revenues and lower revenues from the Governor's tax initiative in 2012-13. Under the Governor's plan, new revenues from the tax initiative are budgeted on an accrual basis. How will all of these revenue factors affect the level of Proposition 98 funding under the Governor's plan in 2012-13? How will these revenue factors affect the level of funding for the Governor's alternative budget if the tax initiative does not pass?

What level of funding would the Governor's proposal provide for Proposition 98 funding beyond the budget year? According to the LAO, while the Governor's plan is difficult in 2012-13, his plan would improve notably the outlook for K-14 education over the next four years.

How do programmatic rebenching adjustments affect the minimum guarantee? The Governor proposes a series of rebenching adjustments to the minimum guarantee that are tied to both revenue changes and program shifts in and out of Proposition 98. Several of these adjustments reflect updates based upon the 1986-87 costs of the program. According to the Administration, "the 1986-87 level cost methodology was used for previous rebenchings and, therefore, the change provides a single and consistent methodology for all rebenching adjustments." What is the net effect of all these rebenchings on the Proposition 98 guarantee?

Governor's Alternative Budget:

Why are realignment-related sales taxes excluded from Proposition 98? The Governor's alternative budget assumes payments to make up approximately $2.1 billion in excluded sales taxes in 2011-12, pursuant to AB 114. These payments will be made over a five year period beginning in 2012-13. However, the Governor excludes sales taxes from calculation of the Proposition 98 minimum guarantee in 2012-13. While AB 114 seems to require that the state add sales taxes to the Proposition 98 calculations in 2011-12, and beyond, this is not the Administration's interpretation. If the tax initiative fails passage, the Administration does not believe that current statutes require realignment-related sales taxes to be added back to the Proposition 98 calculation in the future. Additionally, the Administration does not believe that the $2.1 billion in payment owed for 2011-12 would become a part of the Proposition 98 base moving forward.

What is the appropriate K-14 share of trigger cuts? Proposition 98 funding reductions for K-14 education would total $4.8 billion in 2012-13 per the Governor's alternative plan, which equates to about 90 percent of the 2012-13 trigger cuts. On face, K-14 education is taking a large share of the trigger cuts.

What is behind the Governor's proposal to shift general obligation payments for K-14 education within the Proposition 98 budget? The Governor's proposal would shift K-14 education general obligation bond debt service payments into Proposition 98, thereby displacing existing education program spending. It appears that this shift would allow the state to make programmatic reductions and still fund the Proposition 98 minimum guarantee, thus avoiding a suspension. The Governor also proposes to include state general obligation bond debt payments for the University of California and California State University within the respective budgets for these two higher education segments.

What is the impact of $2.4 billion in programmatic trigger cuts? The Governor proposes to work with K-12 schools and community colleges to develop the details for proposed trigger cuts. According to the Administration, a reduction of this magnitude equates to a reduction of more than three weeks of instruction for K-12 schools. The LAO estimates this cut would reduce K-12 per pupil spending by six percent. These additional trigger cuts would be layered on substantial, ongoing revenue limit base and categorical programs reductions in the billions, as well as **$436 million** in 2011-12 trigger cuts for K-12 school programs.

What's the best way to structure trigger cuts in 2012-13? The LAO has raised concerns that the Governor's alternative budget plan is based upon revenues that will not materialize until mid-year and then has a relatively severe back-up plan in case the revenues do not materialize. The LAO is concerned that such an approach generates significant uncertainty for K-12 school districts in particular. The LAO suggests that the Legislature be very deliberate in developing a trigger package, "its size and essence will determine the size and quality of California's 2012-13 K-14 education program."

What is the impact of elimination of $2.4 billion deferral buy down for K-14 education? In making the trigger cuts, the Governor turns first to eliminating the K-14 deferral buy-down to avoid programmatic reductions. Elimination of the buy down would eliminate any prospects of cash relief for school districts and community colleges in 2012-13. However, there are certainly local borrowing costs associated with deferring **$10.4 billion** (about 20 percent) in annual payments to the next fiscal year. Are ongoing deferrals of this level sustainable for K-12 schools and community colleges for continued borrowing, especially as they deplete budget reserves and one-time federal funds?

What are the long-term effects of the Administration's approach for paying maintenance factor in 2012-13? In recent years there has been disagreement about *when* maintenance factor is created and paid. Some of the new and ever-changing Proposition 98 scenarios may not have been contemplated by the constitutional provisions of Proposition 98. In addition to disagreement about when maintenance factor is paid, there has been disagreement about *how* maintenance factor is paid. Confusion about when maintenance factor is paid continues in 2012-13. The Administration estimates that Test 1 will be the Proposition 98 test in 2012-13. While Test 1 has been operative in several recent years, it has been lower than Test 2, so when maintenance factor payments were paid on top of Test 1, they were lower than Test 2. In 2012-13, Test 1 will be higher than Test 2. This situation has never occurred before in Proposition 98 history. It rekindles recent debates about when and how maintenance factor should be paid. Paying maintenance factor on top of Test 1 – when it is higher than Test 2 – could significantly increase the minimum guarantee in years with strong growth in General Fund revenues.

K-12 Finance - Weighted Pupil Formula

BACKGROUND:

As a means of meeting education cutbacks, state budget packages have granted K-12 schools substantial funding flexibility since 2008-09. Currently, the state allows K-12 schools to use more than **$4.4 billion** in categorical funds "for any educational purpose". This flexibility has been granted to **38 categorical programs** for a seven year period ending in 2014-15. Funding for these individual programs continues – reflecting overall reductions of nearly 20 percent -- that will also continue through the end of 2014-15. District allocations for categorical programs in the flexibility program are based generally upon the proportion of state funding the district received for each categorical in 2008-09. These district proportions will continue through 2014-5, with no adjustments for enrollment (growth or decline).

GOVERNOR'S PROPOSAL:

Problems with Existing School Finance System.

According to the Governor, California's school finance system has become too complex, administratively costly and inequitable. There are many different funding streams, each with its own allocation formula and spending restrictions. Many program allocations have been frozen and no longer reflect demographic and other changes. Furthermore, the fiscal flexibility that has recently been provided to schools is time−limited and excludes some significant programs.

Governor's Funding Flexibility and Accountability Plan.

To remedy problems with the existing school finance system, the Governor proposes a "weighted pupil formula" that will provide significant and permanent additional flexibility to local districts by consolidating the vast majority of categorical programs and revenue limit funding into a single source of funding.

The formula will distribute these combined resources to schools based on weighted factors that account for the variability in costs of educating specific student populations, thereby ensuring that funds will continue to be targeted to schools with large populations of disadvantaged pupils. The funding formula will be phased in over a period of five years.

All of the programs that will be replaced by the formula will immediately be made completely flexible for use in supporting any locally determined educational purpose.

This proposal will be coupled with a system of accountability measures that will be the basis for evaluating and rewarding school performance under this finance model. These measures will include the current quantitative, test−based accountability measures, along with locally developed assessments and qualitative measures of schools.

Major Features of the Governor's Weighted Pupil Formula.

Consolidation of Most Education Programs into Single Funding Stream Beginning in 2012-13. The Governor's proposal consolidates revenue limit apportionments and 42 state categorical programs into a weighted pupil formula - beginning in 2012-13. The newly proposed formula would provide a basic per pupil allocation with additional "weights" for economically disadvantaged pupils and English learner pupils. The new formula would apply to school districts, county office of education, and charter schools.

The weighted pupil formula would be phased in over a five year period, beginning in 2012-13. Through consolidation of **$34.4 billion** in revenue limit apportionments and **$6.9 billion** in categorical funding, the weighted student formula would ultimately reflect **$41.4 billion** in K-12 education funding. The 42 categorical programs included in the weighted student formula proposal are listed below.

K-12 Programs Included in the Weighted Pupil Formula
(Dollars in Thousands)

Item	Program	2012-13		Item	Program	2012-13
103	Apprentice Programs	$ 15,694		208	Civic Education	200
104	Summer School Programs	336,246		209	Teacher Dismissal Apportionments	38
105	ROC/Ps	384,708		211	Charter Schools Block Grant	180,006
108	Grade 7-12 Counseling	167,056		211	Charter EIA	102,242
119	Foster Youth Programs	15,096		227	Community Based English Tutoring	40,082
122	Specialized Secondary Program Grants	4,892		228	School Safety Block Grant	79,932
124	Gifted and Talented	44,225		232	High School Class Size Reduction	78,950
128	Economic Impact Aid	944,447			Statutory K-3 CSR	1,326,200
137	Professional Development Institutes for Math and English	45,476		240	Advanced Placement Grant Programs	2,443
144	Principal Training	3,928		242	Student Leadership/CA Association of Student Councils	26
156	Adult Education	634,805		243	Pupil Retention Block Grant	76,675
158	Adults in Correctional Facilities	14,967		244	Teacher Credentialing Block Grant	90,404
166	Partnership Academies	21,428		245	Professional Development Block Grant	218,380
167	Agricultural Vocational Education	4,134		246	Targeted Instructional Improvement Block Grant	855,131
181	Educational Technology	14,073		247	School and Library Improvement Block Grant	370,000
188	Deferred Maintenance	250,826		248	School Safety Competitive Grant	14,349
189	Instructional Materials Block Grant	333,689		260	Physical Education Block Grant	33,519
193	Staff Development	25,957		265	Arts and Music Block Grant	87,987
195	National Board Certification	2,405		267	Certificated Staff Mentoring	8,583
198	California School Age Families Education Program	46,419		268	Oral Health Assessments	3,527
204	California High School Exit Exam	58,322		6360-101	Alternative Credentialing	26,191
					Subtotal, Categorical Programs	**$6,963,658**
					Subtotal, Revenue Limit Apportionments	**34,406,159**

In order to phase in the new formula, the Administration proposes to provide 80 percent funding according to current funding formulas and 20 percent funding according to the new weighted pupil formula in 2012-13. The percent of new formula implemented would increase by twenty percent each year, over the next five fiscal years, until the new formula was fully implemented in 2016-17.

The Governor does not propose to hold K-12 local educational agencies (LEAs) harmless from any loss of funding resulting from phase- in of the weighted student formula. Without additional funding, existing funds would have to be reallocated among districts to phase-in the new formula.

While the specific impact of reallocation is not known, there will likely be some LEAS who gain and some LEAs who lose funding, as well as, some LEAs that remain about the same level of funding. In general, LEAs with larger numbers and concentrations of economically disadvantaged pupils and English learner pupils will probably gain funding, while districts with lower numbers and concentrations of these pupils will lose relative to current funding levels.

The Administration has indicated it will release data in the next few weeks that will identify funding levels for LEAs under the weighted pupil formula.

Elements of the Weighted Student Formula. While the Administration will be releasing more details soon, the Administration has indicated that the Governor's weighted pupil formula is based upon a modified version of the formula recommended by an issue brief published by the Warren Institute in 2008.[1] The Governor's new formula includes two recommended components of the Warren Institute brief: (1) base funding and (2) targeted funding for low-income students and English learners. In lieu of revenue limit apportionments and funding for most existing categorical programs, the new formula would provide:

- **Base funding** allocated on an unspecified, but equal amount per-pupil for all school districts, county offices of education, and charter schools; and

- **Targeted funding** for educationally disadvantaged pupils based upon pupil weights. Specifically, school districts, county offices of education, and charter schools would receive an additional 37 percent in base funding for low-income pupils and/or English learner pupils. (These would be unduplicated pupil counts so that pupils who are low-income and English learners are not double counted.) School districts, county offices, and charter schools with larger proportions of disadvantaged pupils would receive supplemental "concentration" funding. More precisely, when targeted pupil concentrations reach more than 50 percent of enrollment, the targeted per pupil amount would increase. Graduated increases would be provided, as pupil concentrations grow, and would reach up to double the targeted per pupil amount, if pupil concentrations reach 100 percent.

[1] Alan Bersin, Michael W. Kirst, and Goodwin Liu. *Getting Beyond the Facts: Reforming California School Finance*, The Chief Justice Earl Warren Institute on Race, Ethnicity & Diversity, University of California, Berkeley Law School, April 2008.

Programs Excluded from the Weighted Pupil Formula. The Governor proposes to exclude a total of **12 categorical programs** – accounting for **$4.5 billion** in state funding - from the weighted pupil formula. These programs are listed in the table below.

K-12 Categorical Programs Excluded from the Weighted Pupil Formula		
Budget Item	**Program**	**2012-13**
107	County Office Oversight (FCMAT)	$ 9,169
113	Student Assessments Programs	80,901
150	American Indian Early Education Programs	531
151	Indian Education Centers	3,639
161	Special Education	3,220,931
182	K12 Internet Access	8,340
190	Community Day School	41,685
196	State Preschool Program (Half Day Preschool)	310,188
203	Child Nutrition	155,232
220	Charter School Facility Grants	92,031
266	County Offices of Education Oversight	8,016
649	After-School Education and Safety Services (Proposition 49)	547,025
	Subtotal	**$4,477,688**

The Governor would exclude some categorical programs from the new weighted pupil formula for some specific purposes, such as meeting federal maintenance of effort (MOE) requirements. Two large programs – special education (the largest by far) and child nutrition – are excluded for this purpose.

Another large program, the After School Education Safety program, is excluded because it was authorized by a state ballot measure -- Proposition 49. The state preschool program, which provides education programs for low-income three and four year olds, is excluded by the Governor because it is not a K-12 program.

Most – but not all -- other programs appear excluded because they are considered state-level programs or projects, such as student assessments, fiscal and program oversight, and shared technology.

Another large categorical program excluded from the Governor's weighted pupil formula is the Quality Education Investment Act (QEIA). This program is not reflected on the Governor's list of excluded programs probably because it is funded with non-98 General Fund and perhaps because it is a limited–term program, which ends in 2014-15. The Governor proposes **$450 million** for the program in 2012-13.

The Governor's proposal involves state funded programs only, and therefore does not involve $**6.9 billion** in funding for more than 20 federal programs for K-12 schools in 2012-13.

Full Flexibility for Programs in the Weighted Pupil Formula in 2012-13. Per the Administration, all 42 categorical programs included in the new funding formula would be subject to full and permanent flexibility beginning in 2012-13.

The Governor would add eight existing categorical programs to the current categorical flexibility program list including, three large programs -- K-3 Class Size Reduction, Economic Impact Aid, and Charter School Economic Aid – and six other programs -- Foster Youth Programs, Adults in Correctional Facilities, Partnership Academies, Agricultural Vocational Education, Apprenticeship, and Student Leadership.

The Governor proposes to remove four programs from the existing flexibility program in 2012-13 and beyond – American Indian Education Centers, Indian Education Centers, Community Day Schools, and County Office of Education program oversight.

The Administration has not provided specific language about how this expanded program flexibility would be implemented for programs in the long-term. Under the existing program, which extends through 2014-15, K-12 schools can use funding from 38 programs for any educational purpose, notwithstanding authorizing statutes for each of these programs which remain on the books.

New Accountability Requirements Delayed Until 2013-14. The Governor's new funding stream would be accompanied by new accountability requirements for schools and would provide fiscal rewards for school performance, but not until 2013-14.

While both phase-in of the new weighted pupil formula and the expanded flexibility provisions for additional categorical programs would commence in 2012-13, the new accountability requirements would not be added until 2013-14 – one year after commencement of the Governor's major reforms. While there are few details yet, the Administration has indicated that a working group will be convened in 2012-13 to assess existing statewide accountability requirements and determine what requirements might need to be strengthened in 2013-14.

Governor's Related Proposals.

Eliminate Requirement for New Transitional Kindergarten Program. The Governor believes this is a time for reinvestment and reform of core programs, not for program expansions. As such, the Governor does not fund the new Transitional Kindergarten program created pursuant to Chapter 705, Statutes of 2010. Specifically, the Governor's proposal would:

- Eliminate the requirement for a Transitional Kindergarten, which would require a new two –year, kindergarten program for all pupils who are no longer eligible for Kindergarten beginning in 2012-13;
- Change existing statute to allow pupils who receive a district "waiver" to attend Kindergarten before they are five years old to receive funding from the beginning of the school year, instead of when they turn five. The Governor would allow up to two years of Kindergarten for pupils with such waivers. In addition, the Governor would also strengthen existing law to

clarify that pupils granted Kindergarten waivers must be developmentally ready for traditional Kindergarten; and
- Increase the preschool eligibility age to include low-income pupils who are no longer eligible for Kindergarten beginning in 2012-13.

The Governor estimates cost avoidance of up to $223.7 million from eliminating the requirement for the new Transitional Kindergarten program.

Streamline and Expand Financial Support for Charter Schools. The Governor's weighted pupil formula would be provided to charter schools, as well as school districts and county offices of education. As proposed, existing charter school funding streams – primarily revenue limits, charter categorical block grants, and categorical funds charters apply directly for – would be replaced by the weighted pupil formula beginning in 2012-13. On a related front, the Governor proposes the following changes to expand access and improve equity in 2012-13, as follows:

- **Enhance Charter School Funding**. Improve access to existing funding streams for all charter schools, including non-classroom based charter schools.
- **Invest in Charter School Facilities.** Provide greater charter school access to Charter Schools Facilities Grant program funds and ensuring the timely release of funds. (This program is excluded from the Governor's weighted pupil formula.)
- **Improve Charter School Working Capital.** Provide additional authority to the California School Finance Authority to expand working capital to charter schools.
- **Provide Access to State Mandates Funding**. The Governor also includes charter schools in his proposed mandate block grant, which replaces the existing education mandates program. Currently charter schools cannot access state education mandate funding.

Eliminate Funding for School Transportation Program. The Governor proposes to eliminate the school transportation categorical program in 2012-13, resulting in $486 million in Proposition 98 savings. For this reason, the Governor does not include school transportation programs in his weighted pupil formula or full flexibility program.

The June 2011-12 budget package included $248 million in trigger cuts that eliminated the second half of the school transportation program in 2011-12. The Governor's 2012-13 proposal is intended to continue elimination of school transportation in 2012-13. SB 81, recently passed by the Legislature, would restore $248 million in school transportation trigger cuts and replace them with $248 million in additional revenue limit cuts in 2011-12.

ISSUES TO CONSIDER:

Does the Governor believe that school finance reforms depend upon additional funding? Without new funding, how would the Governor's weighted pupil formula affect funding levels for LEAs beginning in 2012-13? The Governor does not propose to hold LEAs harmless from any loss of current funding. Instead, the Governor is proposing to begin phase-in of the new formula through reallocation of existing funding. What would it cost to hold LEAs harmless from any funding loss under the Governor's proposal? How would phase-in of the new formula work for LEAs – especially since LEAs are living with significant ongoing revenue limit and categorical funding reductions?

What options might exist for providing some new funding for implementation of the Governor's weighted pupil formula? The LAO November forecast projected a more robust economy beginning in 2013-14 and beyond, that would provide notable growth for the Proposition 98 guarantee. More recently, the LAO has indicated that the Governor's plan would improve "notably" the outlook for schools for four years following 2013-14.

Does the Governor's formula provide the best definition of poverty? The Governor's proposal would use the number of pupils reported by schools as eligible for free- or reduced-price meals (FRPM) as the as the measure of economic disadvantage. Given the importance of the poverty factor, is this an accurate poverty measure? Are there other better alternatives? How would different poverty measures affect for the weighted pupil formula?

How do English learner and poverty counts interact? The Governor's proposal would use the number of pupils identified by schools as "English learners" as the measure for English learner pupils. Per the Warren Institute brief, approximately 85 percent of English Learner pupils are low–income. Since the Governor's proposal would utilize unduplicated counts for targeted pupils, the English learner counts would reflect the 15 percent of pupils who are not low-income. In total, about 60 percent of students statewide would be included in the unduplicated targeted pupil counts, including both low-income and English learner pupils.

Does the Governor's proposal provide sufficient assurances that funds will ultimately benefit targeted students – low-income pupils and English learner pupils? Per the Administration, the Governor's school finance proposals are intended to empower local school officials to determine the best use of scarce resources. What assurances does the state have that funds allocated for targeted pupils are expended for targeted pupils? The accountability provisions, that are largely unknown, will be an important part of the State's oversight.

Does the Governor see any risks from adding Economic Impact Aid (EIA) to the flexibility program in 2012-13? The Governor's proposal adds several categorical programs to the current flexibility program beginning in 2012-13, including EIA. Per the Governor's proposal, the funding requirements for a total of 42 categorical programs would be permanently flexed – so that funds could be expended for any educational purpose. Funding allocations for these 42 programs would be phased into the weighted pupil formula over the next five years. Given historic under-performance of low-income and English learner pupils, are there some funding requirements that should be retained for this program in the short- or long-term, especially since the accountability improvements are not scheduled until 2013-14, a year after full funding flexibility occurs.

Did the Governor consider grade-span factors as a part of the base formula to better reflect the cost variances for elementary, middle and high school? The Warren Institute brief did not recommend a base formula for each grade-span. However, the brief did raise grade-span base funding levels as a question for policymakers to consider in moving forward with a weighted pupil formula. What is known about the true education cost differences for different elementary, middle, and high school pupils?

The Governor does not include the Special Education program as a part of his finance reforms at this time. Are some reforms still possible? The special education formulas were updated in the late 1990's, and as such, might not fit into the targeted pupil formula. However, given the size and complexity of this categorical program – the largest state categorical program – is there room for some reform to make allocations more equitable, streamlined, and transparent?

How would the Governor's proposal affect the level of funding for Charter Schools? The Governor's weighted pupil formula would provide funding for school districts, county offices, and charter schools. This would appear to make charter school funding the same as funding for districts and county offices. The Governor also proposes to increase access to all charter school funding for non-classroom based charter schools.

K-12 Education Mandate Reforms

BACKGROUND:

Underlying Problems. According to the Governor, the significant shortcomings of existing K-14 education mandates and the process for administering them compel reform of education mandates. According to the Governor:

- Many existing mandates fail to serve a compelling purpose;
- The mandates determination process takes years;
- The reimbursement costs for mandates are very often higher than anticipated and can vary greatly district by district; and
- The reimbursement process rewards inefficiency.

Annual Budget Appropriations for Mandates. Once approved by the Commission on State Mandates, the Legislature currently has three basic options for handling state education mandates:

- ***Fund.*** The Legislature may appropriate funding for each mandate based upon the State Controller's Office Statewide Cost Estimate Report.
- ***Suspend.*** Alternatively, the Legislature may choose to "suspend" a mandate by eliminating funding in the budget and adding provisional language stating the mandate is suspended. When a mandate is suspended, local responsibilities for providing the mandate and state obligations for funding the mandate are also suspended. In recent years, five mandates applying to school districts (three of which also apply to community colleges) are suspended.
- ***Repeal***. The Legislature may also choose to repeal a mandate by eliminating funding in the budget and repealing the underlying statute.

In 2002-03, the Legislature adopted the practice of deferring payments for K-14 education mandates as a means of achieving state budget savings. With this practice, annual appropriations were virtually eliminated (limited to $1,000 per mandate) and full payments were deferred to future years, although local agency obligations to provide the mandated services continued. However, the courts have recently clarified that K-12 schools and community colleges must fully fund, suspend, or eliminate mandates, so the state can no longer defer mandate payments.

Annual Mandate Costs Growing. The 2011-12 budget provides **$90 million** to cover the costs of annual mandate claims. However, according to the LAO the annual cost of K-14 mandates is projected to be **$180 million** at the end of 2011-12.

Prior Year Mandate Claims Significant and Growing. The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. These large unfunded balances resulted in part from the practice of deferring annual mandate payments as a means of achieving budget savings. These unpaid claims constitute a growing state obligation that must be paid eventually, once claims are audited and approved. The state must also pay interest on overdue claims, based upon the rate established for the Pooled Money Investment Account. According the State Controller's Office, as of June 30, 2011, the state owed **$69.7 million** in accrued interest on school mandates.

GOVERNOR'S PROPOSAL:

K−14 Education Mandate Reform Plan. The Budget provides a total of **$200 million** to fund a mandates block grant incentive program for K−12 schools and community colleges. Legislation will eliminate almost half of all current K−14 mandates and will create incentives for schools and community colleges to continue to comply with remaining previously mandated activities. More specifically, the Governor's proposal would:

- **Repeal Mandates.** The proposal will eliminate nearly half of all existing mandates, including Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. While the mandate to perform these activities will be eliminated, local districts may choose to continue these activities at local discretion.
- **Preserve Core Programs and Functions.** Mandates that are not eliminated will be made optional. However, the proposal creates a block grant to encourage schools to continue meeting these requirements. Receipt of funding from this block grant will be conditioned on schools complying with these provisions. The proposal will sustain core programs, including school and county office fiscal accountability reporting. It will also continue to support sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks

Major Features of Governor's Proposal.

The Governor proposes major changes to existing K-14 education mandates programs and funding in 2012-13. Major features are outlined below:

- **Eliminates More Than Half of Mandates.** The Governor proposes to eliminate 29 K-14 education mandates in 2012-13. This total includes 16 K-12-only mandates, five community colleges-only mandates, and eight mandates that apply to both schools and colleges. Mandates proposed for elimination include:
  - **K-12 Education (16):** Behavioral Intervention Plans (BIP), Caregiver Affidavits, Consolidation of Law Enforcement Agency Notifications (LEAN) and Missing Children Reports, Consolidation of Notification to Teachers: Pupils Subject to Suspension or Expulsion I and II and Pupil Discipline Records, County Treasury Withdrawals, Financial and Compliance Audits, Graduation Requirements, Habitual Truants, Notification of Truancy, Physical Education Reports, Physical Education Tests, Pupil Residency Verification, Pupil Suspensions, Expulsions, Expulsion Appeals, Removal of Chemicals, School Bus Safety I and II, Scoliosis Screening.

- **Community Colleges (5):** Health Fee Elimination, Integrated Waste Management, Law Enforcement Jurisdiction Agreements, Reporting Improper Governmental Activities, Sexual Assault Response Procedures.

- **K-14 Education (8):** Absentee Ballots, Agency Fee Arrangements, Grand Jury Proceedings, Health Benefits for Survivors of Peace Officers and Firefighters, Law Enforcement Sexual Harassment Training, Mandate Reimbursement Process, Student Records, Threats Against Peace Officers.

- **Continues Most Remaining Mandates & Includes in New Block Grant**. The Governor proposes to continue 26 K-14 mandates and cover the mandated activities for each within the new mandates block grant. These mandates include: 21 K-12-only mandates, two community college-only mandates, and three mandates that apply to both K-12 schools and community colleges, including:

  - **K-12 Education (21):** AIDS Instruction and AIDS Prevention Instruction, California State Teachers Retirement System Services Credit, California High School Exit Exam, Charter Schools I, II, and III, Comprehensive School Safety Plans, Consolidation of Annual Parent Notification/Schoolsite Discipline Rules/Alternative Schools, County Office of Education Fiscal Accountability Reporting, Criminal Background Checks, Criminal Background Checks II, Differential Pay and Reemployment, Immunization Records, Immunization Records-Hepatitis B, Intra-District Attendance, Juvenile Court Notices II, Pupil Health Screenings, Pupil Promotion and Retention, Pupil Safety Notices, School Accountability Report Cards II and III, School District Fiscal Accountability Reporting, School District Reorganization, Stull Act.

  - **Community Colleges (2):** California State Teachers Retirement System, Sex Offenders: Disclosure Requirements.

  - **K-14 Education (3):** Collective Bargaining, Open Meetings/Brown Act, Prevailing Wage.

Proposed Funding for New Mandate Block Grant Program. Provides a total of **$200 million** to establish separate block grants to provide incentive funding for K-12 schools and community colleges that comply with mandates in 2012-13. Block grant funds would be allocated on a per-pupil basis to K-12 schools and community colleges that choose to participate in the new mandate block grant. The $200 million in funding for new K-14 block grants represents an increase of **$110 million,** which more than doubles the amount of funding appropriated for K-14 mandates in the 2011-12 budget.

Mandate Funding Proposal (dollars in millions)

Dollars in Millions	Budget Act Item	2011-12	2012-13	Change
K-12 Education	6110-295-0001	$80.4	$178	97.6%
Community Colleges	6870-295-0001	9.5	22	12.5%
Total		**$89.9**	**$200**	110.1%

The Governor's new block grant proposal would provide **$178 million** for K-12 education and **$22 million** for community colleges. The Administration estimates that the new block grant will provide a **340 percent increase** in funding and will encourage schools to sustain core education, health and safety, and accountability mandates.

Two Large Mandates Eliminated. The Governor's plan includes elimination of two of the most costly K-12 mandates including High School Science Graduation Requirements and Behavioral Intervention Plans. Each of these mandates carries significant prior year and ongoing costs to the state. Additional detail is provided below for each of these mandates.

Science Graduation Requirement Mandate.

As part of major education reform legislation in the early 1980s, the Legislature increased the state's high school graduation requirements. Among other changes, the law required that all students complete two high school science classes prior to receiving a diploma (the previous requirement was one science class). This change raised the total number of state-required courses from 12 to 13.

The costs associated with providing an additional science class were the basis of an eventual mandate claim. In 1987, CSM determined that providing an additional science class imposes a higher level of service on districts and, therefore, constituted a reimbursable mandate.

In 2004, a court ruling indicated that school districts had full discretion to increase their total graduation requirements and total instructional costs. Based on this 2004 ruling, CSM decided the state could not increase the number of courses it requires for graduation above 12 courses without providing reimbursement.

According to the latest data from the State Controller's Office, annual costs for the science graduation requirement total about **$250 million** a year. Prior year claims are estimated at **$2.5 billion** for this mandate.

A number of mandate reforms were enacted in the 2010-11 budget package. These reforms included modifications to the Science Graduation Requirement mandate intended to retain the underlying statute, while eliminating mandate cost requirements.

Behavior Intervention Plan Services Mandate.

Federal law entitles children with disabilities to a "free and appropriate education" (FAPE) tailored to their unique needs. In order to achieve these goals, districts are responsible for providing special education and related services pursuant to an Individualized Education Program (IEP), which is developed by an IEP team -- including parents -- with special education expertise and knowledge of a child's particular needs.

Chapter 959, Statutes of 1990 (AB 2586, Hughes), sought to regulate the use of behavioral interventions and encourage the use of positive behavioral strategies with special education students, as a part of the IEP process. In so doing, Chapter 959 required the State Board of Education (SBE) to adopt regulations that (1) specified the types of behavioral interventions districts could and could not use; (2) required IEPs to include, if appropriate, a description of positive interventions; and (3) established guidelines for emergency interventions.

The SBE adopted regulations that require districts to conduct a "functional assessment analysis" and develop a Behavioral Intervention Plan (BIP) for students with disabilities exhibiting serious behavior issues. SBE regulations also require districts to train staff to implement BIPs.

In 1994, three school districts filed a claim arguing that BIP-related requirements constituted a reimbursable mandate. In reviewing the claim, the Commission on State Mandates staff found that state statute, "on its face, does not impose any reimbursable state mandated activities," **however, regulations adopted pursuant to state law were found to constitute a state mandate.**

At the time BIP-related regulations were implemented, federal law was silent on the use of behavioral interventions. In 1997, however, federal law was amended to include behavioral interventions in the IEP process. Per the LAO, under state law, if a student with a disability exhibits behavior that impedes his or her education, school districts are required to perform three primary activities: (1) assess the student's behavior using a "functional analysis assessment," (2) implement a plan for addressing the behavior (the BIP), and (3) ensure teachers are properly trained to perform BIPs. Per the LAO, after state laws and regulations were adopted, the federal government essentially chose to require the same primary activities.

According to recent estimates, annual claims costs for the BIP mandate total about **$65 million** a year. Prior year claims are estimated at **$1.0 billion** for this mandate.

BIP statutes were also updated in 2010-11 budget package to clarify federal special education mandates covering positive behavior services for students with disabilities. The intent of these changes was to retain the underlying BIP statute, but eliminate mandated cost requirements.

ISSUES TO CONSIDER:

Does the Administration anticipate long–term savings or other efficiencies with this proposal? The Governor proposes an increase of $110 million in 2012-13 – which will provide a total of $200 million to K-12 schools and community colleges for the new mandate block grant. How does this compare to the long-term costs that will be incurred if the mandates continue under the current mechanism? In addition, the block grant approach will presumably distribute the mandate expenditures in a more equitable and uniform way. Given the current system is fraught with inequities as different districts get reimbursed for different amounts for what are ostensibly the same activities. Furthermore, a significant number of claims are found to be ineligible for reimbursement and the block grant approach would seem to streamline the significant administrative effort that goes into the claiming process which is sometimes for not.

Under the Governor's plan do mandates in the block grant remain mandates? Could districts still claim for these mandates, if they chose to do so? Is there a risk to retaining mandates within the block grant? Would it be better to suspend the mandates and continue the activities within the new block grant?

The Governor proposes to fully address the backlog of prior year mandate claims by the end of 2015-16. The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. The Governor has identified these obligations as a part of his Wall of Debt, and would retire this debt over the next few years if the tax initiative is approved by voters.

How does the Governor's plan address future mandates? How would the activities of the Commission on State Mandates and State Controller's Office (SCO) change? The Commission on State Mandates has a number of mandate claims in the pipeline. Would all new mandates be added to the new block grant? Under the block grant, how would mandates be audited to assure that K-12 schools and community colleges were providing the mandated services?

The Governor's plan eliminates the mandate claiming reimbursement mandate? What is the reason for this? How much do K-12 schools and community colleges spend annually on mandate claiming? Reportedly, school districts spend in the tens of millions of dollars on the mandate claiming process? Some districts hire outside contractors to perform this function. Other districts provide this service in-house or simply do not file mandate claims because benefits outweigh the costs.

Under the Governor's plan, how would the new block grant be administered? The Administration has provided preliminary language that would authorize funding for the Department of Education to administer the new mandate block grant.

Why does the Governor eliminate the Science Graduation Requirement? The estimated cost of the science graduation mandate is large – more than double all other K-12 mandates combined. In addition, the backlog of prior year costs covers more 15 years of claims. However, the Science Graduation Requirement mandate was modified in 2010-11 as a part of mandate budget reforms to retain the mandate but remove any required costs. Does the Administration believe these changes were insufficient to protect the State from additional claims?

Why does the Governor eliminate the Behavior Intervention Plan (BIP) mandate? The BIP mandate was also modified in 2010-11 to retain the mandate but remove any required costs. Does the Administration believe another approach is required to protect the State from additional claims?

Child Care and Early Childhood Education

BACKGROUND:

There are many different programs that invest in child care and early childhood education. Direct child care and early childhood education services are currently funded by every level of government (federal, state, and local), including local school districts and the First 5 County Commissions. These programs have developed through separate efforts to achieve a variety of goals, including but not limited to, providing the child care necessary so that parents can work, and providing an educational environment that helps prepare young children for success in school.

State Funded Programs. Historically, the state has funded the following programs:

- CalWORKs Child Care (Stages 1, 2 and 3) – recipients of CalWORKs assistance are eligible for subsidized child care. This care is administered in three stages. All CalWORKs providers are paid through a voucher reimbursement system based on regional market rates (RMR).
- Non-CalWORKs Child Care (General Child Care [Title V Centers and Family Child Care Homes], Alternative Payment programs, and Migrant and Severely Handicapped programs) – low-income families not receiving CalWORKs assistance also are eligible for subsidized child care, though demand typically exceeds funded slots.
- State Preschool – early childhood education programs for three-to-five year old children from low-income families. This is the only program that does not require the parents to be working or engaged in some other qualifying activity.

These state-funded programs are primarily administered by the State Department of Education (CDE) with the exception of Stage 1 CalWORKs Child Care, which is administered by the Department of Social Services (DSS). Until the 2011-12 fiscal year, the vast majority of these programs were funded from within the Proposition 98 Guarantee for K-14 education. Currently, all of these programs are supported by non-98 General Fund spending and federal funds, with the exception of part-day State Preschool which continues to be funded from within Proposition 98.

The portion of the General Child Care program that was serving three-and four-year-old children in center-based settings was consolidated with the State Preschool program in 2009 after the passage of Chapter 308, Statutes of 2008 (AB 2759, Jones). A significant portion of the funding for the General Child Care program is now supporting preschool programs and many of them are run by school districts.

In 2011-12, around $1 billion was allocated for CalWORKs Child Care, $933 million for Non-CalWORKs Child Care, and $374 million for State Preschool. These programs were funded with a mix of Proposition 98 General Fund (part-day State Preschool only), Non-Proposition 98 General Fund ($1 billion), and federal funds ($941 million).

Head Start Programs. The federal government invests directly in Head Start programs around the State. These programs serve preschool-age children and their families. Many Head Start programs also provide Early Head Start, which serves infants, toddlers, pregnant women, and their families who have incomes below the federal poverty level.

Head Start programs offer a variety of service models, depending on the needs of the local community. Programs may be based in:

- Centers or schools that children attend for part-day or full-day services;
- Family child care homes; and/or
- Children's own homes, where a staff person visits once a week to provide services to the child and family. Children and families who receive home-based services gather periodically with other enrolled families for a group learning experience facilitated by Head Start staff.

The federal Administration for Children and Families reports that nearly $860 million was expended on Head Start in California in 2009 and nearly 98,000 children were served.

California First 5 and County First 5 Commissions. The California Children and Families Program (known as First 5) was created in 1998 upon voter approval of Proposition 10, the California Children and Families First Act. There are 58 county First 5 commissions as well as the State California and Families Commission (State Commission), which provide early development programs for children through age five. Funding is provided by a Cigarette Tax (50 cents per pack), of which about 80 percent is allocated to the county commissions and 20 percent is allocated to the State Commission. This Act generates about $475 million in new revenues annually.

The First 5 programs are generally directed by the State and County Commissions. Both the State and County Commissions have made early child care and education a priority for expenditure. According to the latest annual report available from First 5 California from 2009-10, the State Commission has invested in the following efforts:

- Power of Preschool - $15.2 million to fund Power of Preschool demonstration projects in certain counties. Power of Preschool provides free, voluntary, high-quality, part-day preschool to assist three- and four-year old children in becoming effective learners with a focus on developing preschool in underserved and high-priority communities.
- School Readiness - $51.7 million to counties for the School Readiness Program that strives to improve the ability of families, schools, and communities to prepare children to enter school ready to learn. Services are provided to focus on family functioning, child development, child health, and systems of care with a specific target to children and their families in schools with an Academic Performance Index score in the lowest three deciles.
- Low Income Investment Fund Constructing Connections - $600,000 to support Constructing Connections that coordinates and delivers technical assistance, training, knowledge, and facility financing information to support child care facilities development through local lead agencies. The Commission indicates that it leveraged more than $86 million in resources to create and renovate child care facilities and spaces.

There is considerable variation county to county; but, on a whole, County Commissions invested $265 million in 2009-10 to improve child development. The County Commissions predominantly invested these funds in Preschool for three- and four-year-olds and State school readiness programs.

Local School Districts. Local school districts have also made considerable investments in early childhood education. Many elementary schools have preschool programs and child care programs on site. In some cases these programs are those described in earlier sections (State Preschool for low income kids, Head Start, or First 5 funded programs). However, in some cases these programs are funded directly by school districts using other funds, including local property tax and parent fees. In addition, school districts have flexibility to use some of their major funding streams on early childhood education. The Title I federal funding that is dedicated to improving the academic achievement of the disadvantaged can be used to support early childhood education. In addition, federal special education funding can also be used to support children demonstrating special needs prior to entering school. The State also has a categorical program called California School Age Families Education (Cal SAFE) that provided money specifically for child care and other supports for parenting students. This program was added to categorical flexibility in 2008-09 and the funds allocated to districts are no longer restricted to the CalSAFE program. The State also provides local school districts with After School Educational and Safety (Proposition 49) funding of about $680 million annually.

Furthermore in 2010, legislation was enacted to create a two-year kindergarten program for students who turn five between September 1 and December 1. The 2012-13 fiscal year is the first year that this two-year program is required to be offered for students that have a birthday between November 1 and December 1. School districts have had the option to offer this early Transitional Kindergarten program on a pilot basis prior to this year and districts have varied greatly in their implementation of this program. Kindergarten (whether one year or two year) is not compulsory in California.

In summary, local school districts have invested in early childhood education, but there is no easy way to quantify the investments that they have made.

Community College Districts. There is also a small amount of funding allocated to the Community College Districts to support subsidized child care for students. This includes funding for the following programs:

- CalWORKs - $9.2 million for subsidized child care for children of CalWORKs recipients. This program is proposed to be part of the Governor's categorical reform and would no longer be restricted for this purpose.
- CARE (Cooperative Agencies Resources for Education) - $9.3 million to provide eligible students with supplemental support services designed to assist low-income single parents to succeed in college. Child care is one of many supports funded by this program. This program is proposed to be part of the Governor's categorical reform and would no longer be restricted for this purpose.
- Child Care Tax Bailout - $3.3 million for certain districts to provide assistance for child care. This program was included in the categorical flex item adopted in the 2009-10 budget, but there has been no change to this program since that time.

GOVERNOR'S PROPOSAL:

Overall Funding. The Governor's budget proposes $1.9 billion in funding for child care programs. This includes $1.5 billion in funding for programs administered by CDE and $442 million in funding for Stage 1 child care administered by DSS. This reflects a reduction of $450 million General Fund or approximately 20 percent of the total program when compared to 2011-12. The Department of Finance (DOF) estimates that this will result in 62,000 fewer child care slots in the budget year.

Child Care and Preschool Program Reductions. The Governor's budget proposes the following reductions to the state funded child care reductions in 2012-13:

- **New Requirements and Reduced Time Limits for Welfare Recipients -** $293.6 million in savings in non-Proposition 98 General Fund by reducing time limits on welfare to work services for adults who are not working sufficient hours in unsubsidized jobs and making other changes. This change will eliminate services for 109,000 families as of April 2013. This reduction will eliminate about 46,300 child care slots. Part-day preschool programs will not be affected by this reduction.

- **Reduce Income Eligibility -** $43.9 million in non-Proposition 98 General Fund savings and $24.1 million in Proposition 98 General Fund savings by reducing the income eligibility ceilings from 70 percent of the state median income to 200 percent of the federal poverty level. Per the Administration, this level equates to 61.5 percent of the state median income for a family size of three, reflecting a reduction in the income ceiling from $42,216 to $37,060. This reduction will eliminate about 15,700 child care slots. This reduction is extended to State Preschool.

- **Eliminate COLA -** $29.9 million in non-Proposition 98 General Fund savings and $11.7 million in Proposition 98 General Fund savings by eliminating the statutory COLA for capped non-CalWORKs child care programs.

- **Reduce Reimbursement Market Rate (RMR) Ceilings -** $11.8 million in non-Proposition 98 General Fund savings by reducing the reimbursement rate ceilings for voucher-based programs from the 85th percentile of the private pay market, based on 2005 market survey data, to the 50th percentile based on 2009 survey data. Per the Administration, to preserve parental choice under lower reimbursement ceilings, rates for license-exempt providers will remain comparable to current levels, and these providers will be required to meet certain health and safety standards as a condition of receiving reimbursement. (A corresponding $5.3 million General Fund decrease is made to Stage 1 in the Department of Social Services budget.)

- **Reduce State Reimbursement Rate (SRR) for Title 5 Centers -** $67.8 million in non-Proposition 98 General Fund savings and $34.1 million in Proposition 98 General Fund savings by reducing the standard reimbursement rate for direct-contracted Title 5 centers by 10 percent.

Child Care Program Redesign and Realignment. The Governor also proposes major changes that would restructure the administration of the child care programs. These changes are consistent with the Administration's proposal to restructure CalWORKs, whereby the Administration intends to focus state funding on low income families working a required number of hours (30 hours per week or 20 hours per week if the family has small children). The Administration proposes to replace the three-stage child care system for current and former CalWORKs recipients and programs serving low-income working parents with a work-based child care system administered by county welfare departments starting in 2013-14. The Governor is proposing a two year process to implement these changes.

- **Year 1--2012-13 Structure.** The Governor proposes to consolidate all funding for Stage 2, 3 and non-CalWORKs Alternative Payment (AP) programs into one block grant to the AP contractors. This block grant would fund child care for families whose children are recipients of child protective services, or at risk of being abused, neglected or exploited, and cash-aided families. Only families meeting the new work requirements would be eligible for the subsidy. Priority would be based on income and the previously listed factors.

DSS**: CalWORKs Child Care Stage 1** will continue to be administered by County Welfare Directors subject to the new work participating requirements. $442 million, 60,313 slots.

CDE: **CalWORKs Child Care Stage 2** is an entitlement for families for two years after the family stops receiving a CalWORKs grant.

CDE: **CalWORKs Child Care Stage 3** is for families that have exhausted the time limit in Stage 2 and are otherwise eligible for child care. Stage 3 is a capped program.

CDE: **Alternative Payment Programs** provide low income families with vouchers for care in a licensed center, family child care home, or by a licensed-exempt provider.

CDE: **New consolidated block grant** to the Alternative Payment contractors to provide vouchers to serve eligible families with priority given to families whose children are recipients of child protective services, or at risk of being abused, neglected, or exploited, and cash-aided families meeting work requirements. $571 million, 82,834 slots.

CDE: Administration of the **General Child Care** program which funds Title 5 centers through direct contracts with the State would not change in the budget year, except for the reduction in income eligibility and reimbursement rate, which would reduce the size of this program considerably. $470 million, 52,809 slots.

- **Year 2--2013-14 Structure.** In Year 2 of the redesign, larger fundamental changes occur regarding the oversight and management of the child care programs. In Year 2 all of the child care funding at CDE (except part-day Preschool) would be consolidated with Stage 1 (administered by DSS) to provide a new consolidated block grant to the Counties. Furthermore, all families including those currently enrolled in Title 5 centers will receive vouchers for a payment to a provider of their own choice.

DSS: **CalWORKs Child Care Stage 1**

CDE: **New Consolidated block grant** (formerly CalWORKs Stages 2 and 3 and Alternative Payment Programs)

CDE: **General Child Care** program.

Counties: **Consolidated child care block grant** to serve eligible families with priority given to families whose children are recipients of child protective services, or at risk of being abused, neglected, or exploited, and cash-aided families meeting work requirements. Counties would have authority to continue to contract with Alternative Payment contractors locally like 27 counties currently do with the Stage 1 program. The DSS would oversee this consolidated program, including the federal Child Care Development Funds.

- **Future of Quality and Other Child Care Activities Uncertain**. The Governor continues the expenditure of $76 million in quality and other child care activities that provide support, development, and referral networks for the child care network through CDE in the budget year. The Administration has indicated that it plans to have DSS and CDE work together on a new plan on how to allocate the quality dollars in 2012-13. Furthermore, the Administration was recently awarded a Race to the Top federal grant to further develop quality child care programs. Generally, the Administration seems to still be developing a long-term plan for the quality and other child care funding components that have historically been administered by CDE.

- **Preschool and AB 2759.** The CDE will continue to administer part-day Preschool under the Governor's proposal. However, as mentioned in the background, a significant amount of the funding in the General Child Care program is currently funding Preschool. In 2009, after the implementation of AB 2759 (Jones), some of the contracts with Title V centers funded with General Child Care program funding were consolidated with State Preschool contracts. The Governor has proposed to unwind this relationship over the next year and realign the General Child Care funding along with other funding to the counties as part of the block grant.

- **Oversight.** The Governor's proposal centers oversight and design of the child care system with the counties starting in 2013-14 and has proposed legislation to provide counties and alternative payment programs with the tools needed to identify and collect overpayments and to impose sanctions on providers and families that commit intentional program violations. Any savings identified would be reinvested in child care slots.

Other Early Childhood Programs. The Governor has also proposed to eliminate a new two-year Kindergarten program (known as Transitional Kindergarten) to save $223.7 million in Proposition 98 funding in the budget year. This program would have commenced a new, early childhood education program for children no longer eligible for Kindergarten. Unlike other early childhood programs, funding would not be needs-based. For example, funding would not be targeted on the basis of income, as is the case with most other child development programs, such as state preschool. Instead, program funding would be provided to all children with birthdays that fall within a three month range. (*There is additional discussion on this proposal in the K-12 section of this report.)*

ISSUES TO CONSIDER:

How Do We Minimize Impacts to Crucial Investments in Child Care? The Governor has proposed a significant redesign of the current state-funded child care programs. However, ultimately the reduced number of child care and early childhood education slots (62,000) will have real impacts on the access to child care, the ability of families to work, and the reduced school readiness for low-income children. Furthermore, recent studies have found that child care and early childhood education efforts have returns on investment to the public ranging from $2.69 to $7.16 per dollar invested. Studies have found that investments in child care and early childhood education have consistently found substantial savings derived from reduced need for remedial and special education, reduced incarceration, and lower rates of teen pregnancy, among many other factors.

While the economy has started to improve, along with State revenues, the budget continues to be extremely constrained. Ultimately, the Legislature will need to weigh options for balancing the budget. However, it will be important to focus these reductions in an effort to minimize impacts to direct services and preserve key infrastructures that would be difficult to rebuild. Furthermore, since part-day Preschool continues to be funded by the Proposition 98 guarantee for K-14 education, the Legislature may wish to further evaluate the mix of funding sources for support of child care and early childhood education.

What About the Governor's CalWORKs Requirements? The single largest reduction in the Governor's child care proposal is to the CalWORKs child care program due to stricter work requirements and lower time limits. The Governor's proposal would require that a parent be working 30 hours per week in unsubsidized employment after two years of services in the CalWORKs program, with minimal exceptions, in order to be eligible for child care. Because the Governor's proposal drops families from the program after a six month period, the number of families losing child care services is especially high in the budget year. In summary, the child care proposal is intertwined with the Governor's larger CalWORKs proposal and these reductions will need to be evaluated together. *(See the discussion of the CalWORKs proposal in a separate section of this report.)*

Who Should Administer Child Care Funding? The Governor has proposed a major shift in the allocation of the child care funding from a program primarily administered by CDE to a program mainly administered by the counties with some oversight from DSS. Nevertheless, it is important to note that the vast majority of the child care programs (CalWORKs and Alternative

Placement programs) are currently run by locally based Alternative Placement agencies and in 27 counties the Alternative Placement agency also manages the Stage 1 contract for child care, which is allocated to the counties by DSS.

In summary, a large portion of the current system is managed locally with some variation from county to county. The exception to this is the Title V centers and Family Child Care Homes, which directly contract with the State through the General Child Care program. This program has the potential to change significantly under the Governor's proposal as the state requirements related to Title V would become optional and counties would not be required to contract with these centers. Furthermore, the Governor's proposal would provide vouchers for all programs in the second year of implementation and given the considerable fixed per classroom costs associated with running a Title V center it is unlikely that these centers could continue without the certainty of a contract or other partnerships with a local school district. In addition, the Governor's rate reduction to the Title V centers in the budget year is likely to provide significant hardship and result in many centers closing their doors, because they have few alternatives to reduce costs and live within the lower rate. In some areas of the state, the Title V centers are reimbursed at a lower rate than other child care centers.

Generally, programs that are good candidates for realignment are programs that would benefit from local innovation and are programs where the State can tolerate some variation in the delivery of services. A large portion of the child care programs fit these qualifications. However, this is not the case with the Title V centers and Family Child Care Homes that are currently directly contracting with the State and adhere to State standards for operation and reimbursement. The Legislature will need to evaluate and determine what role the State will play in preserving the current network of Title V centers.

How Do We Maximize Coordination? There have been significant efforts at the state and federal levels of government to try and reduce the achievement gap of low-income children before they enter school. Furthermore, the voters also passed the First 5 initiative that specifically focuses resources to children ages zero-to-five and their families. Also, the State currently funds numerous separate programs for child care and early childhood education. The Governor's proposal has taken significant steps to streamline and consolidate the State child care programs into a block grant to the counties. This could help to enhance coordination among child care programs and the different early childhood education efforts that are generally locally driven (local First 5 Commissions, local school districts, and others).

One aspect of the Governor's proposal, however, seems to reduce recent gains made to coordinate funding streams. Assembly Bill 2579 (Jones) allowed State contractors to blend State part-day Preschool funds and General Child Care programs to provide three-and four-year-olds with State Preschool and wrap around child care that is needed to help support working parents. This coordination was enacted after there was a general consensus that State part-day Preschool could not be accessed by working parents that needed full day care. The Governor's proposal does away with this effort. Nevertheless, the underlying goals of AB 2759 continue to be extremely important to providing more low-income three-and four-year-olds, with working parents, access to these proven State Preschool programs. The Legislature will want to examine ways in which we can maximize the use of existing child care and early childhood education funding given the numerous funding sources and separate efforts in this area.

California State Library

BACKGROUND:

Founded in 1850, the California State Library (Library) is the oldest and most continuous cultural agency in the state. Among its responsibilities, the Library supports a transparent government by collecting, preserving, and ensuring access to government publications; ensures access to books and information for the visually impaired or those who are otherwise physically handicapped and unable to read standard print; provides library and information services to the legislative and executive branches of state government, members of the public, and public libraries; administers and promotes literacy outreach programs; and develops technological systems to improve resource sharing and enhance access to information.

Federal Library Service and Technology Act Funding

Over the past five years, the state has received each year an average of over $16 million in federal Library Service and Technology Act (LSTA) funding. In 2011, due to cuts at the federal level, the state received about $15.4 million. The federal funds are available for expenditure for two years, require a state match, and support services consistent with the priorities set forth by the LSTA legislation. These federally-supported programs include the following: Braille and Talking Book Library, California Government Information Access/California Portal, Library Materials and Database Acquisition, and Historic California Photograph Digitization.

In order to be eligible for LSTA funding, the state is required to meet federal maintenance of effort (MOE) requirements, as determined by a three-year rolling average of state funds spent on libraries. If the state's average falls, the allotment of dollars to California falls by the similar percentage. Each December, the Library is required to report to the federal government on the amount of state funds expended consistent with the purposes of the LSTA. That state expenditure level, via the MOE calculation, determines the amount of federal funding the state receives the following October (beginning of the federal fiscal year).

State-Funded Local Assistance Library Programs

State-funded local assistance library programs comprise the majority of the state's federal MOE calculation because they demonstrate the state's commitment to libraries and are consistent with the purposes of the LSTA. These programs include the following: (1) <u>California Library Literacy Services</u> provide community-centered assistance to low-literacy adults and their families, including funding for the mobile library program; (2) <u>California Library Services Act</u> promotes resource sharing and reimburses public libraries for loans to individuals living outside their jurisdiction; and (3) <u>California Newspaper Project</u> identifies, describes, and preserves California newspapers. Two other programs are also included in the calculation: (1) <u>Telephonic Reading Program</u> allows persons with visual impairments to use their telephones to listen to more local news, TV Guide listings, archived radio shows, bus schedules, newsletters, and shopping advertisements; and (2) Library Development provides leadership and support of the future of California through its libraries.

As part of the triggers included in the 2011-12 budget, funding for the three local assistance programs, as well as the Public Library Foundation (PLF) and the California Civil Liberties Public Education Program (CCLPEP), were eliminated. These reductions (excluding for PLF and CCLPEP) total nearly $12 million and jeopardize the Library's 2012-14 allotment of federal funds.

Major Sources of Funding (in thousands)

Funding Source	2010-11	2011-12	2011-12 revised	2012-13
General Fund	$10,190	$10,770[2]	$10,770[2]	$12,740[3]
General Fund - Local Assistance	$31,056	$15,866	$0	$0
Central Service Cost Recovery Fund	$1,368	$1,734	$1,734	$1,275
Federal Funds – State Operations[1]	$7,259	$7,257	$7,257	$7,380
Federal Funds – Local Assistance[1]	$12,518	$12,518	$12,518	$12,518
Other Funds (excludes debt service)	$3,655	$2,539	$3,091	$2,616
Total	**$66,046**	**$50,684**	**$35,370**	**$36,529**

[1]Due to calendar differences between the state and federal fiscal years, and the fact that the federal funds are available for expenditure over two years, the amount of federal funding displayed in a given state fiscal year totals greater than $16 million total received from the federal government.
[2]Increased General Funds in 2011-12 were the result of various adjustments, including for the end of employee furloughs.
[3]The 2012-13 General Fund allocation reflects an increase over 2011-12, even in light of the $1.1 million reduction in the budget, due to several factors, including costs associated with the Library's relocation back into the Library & Courts Building which has been under extensive renovations.

GOVERNOR'S PROPOSAL:

The budget continues the January 2012 "trigger cuts" to local assistance library programs through 2012-13. In addition, the budget reduces General Fund support for the Library's operating budget by $1.1 million to reflect the reduced workload due to the elimination of the four local assistance programs.

ISSUES TO CONSIDER:

Library Faces Reductions in Future Federal Grants. The January 2012 "trigger" reductions prevent the Library from fully meeting the federal MOE requirements. The Library's December 2012 report will show a 22 percent drop in meeting the MOE, which means that the Library's allotment for 2012-2014 will be reduced by 21 percent, resulting in additional programmatic reductions in state fiscal year 2013-14. If these local assistance library programs continue to go unfunded in the 2012-13 budget (as currently proposed), the Library anticipates that its December 2013 report to the federal government will show a 85.4 percent drop in meeting the MOE; this will translate to an 85.4 percent reduction in the allotment for 2013-2015, resulting in the need for significantly more programmatic reductions in state fiscal year 2014-15.

What Programs are at Risk by Loss of Federal Funds? A reduction of 85.4 percent would translate to total federal funds of approximately $2.3 million, which is insufficient funding to support even the Braille and Talking Book program and the Southern Braille Institute, which use about $2.6 million of the federal funds each year to operate. More than 42,000 people statewide would lose service and access to information and resources that they can get nowhere else. The Library would also not be able to fund other important information services and projects as about 30 percent of its staff participate in federal projects and are funded through federal funds. Examples of other programs potentially impacted include: California Government Information Access/California Portal; Library Materials and Database Acquisition; Historic California Photograph Digitization; and Library Development.

A Waiver of the Federal MOE Requirements is Possible. States can apply to the federal government for a waiver of the MOE requirements. The guidelines state that a waiver would be equitable due to "exceptional or uncontrollable circumstances such as a natural disaster or a precipitous and unforeseen decline in the financial resources of the state." The waiver application also requires documentation of whether or not the reductions to the state library are proportionate to all other state agencies. In 2011, 12 state libraries could not meet their MOE and 10 of those states applied for waivers. In 2012, the Library anticipates that at least 27 state libraries will not be able to meet the MOE requirements. The Library indicates that they plan to submit a waiver.

How Much Funding is Needed to Meet the Federal MOE Requirements? The Library indicates that approximately $17.1 million in funding is needed in 2012-13 in order to fully meet the federal MOE requirements and maintain the historical level of LSTA funding.

Local Library Reliance on State Funds. The Library reports that 110 public libraries reported a decrease in funding in 2010-11, representing 60 percent of the public libraries in California. Some local libraries are far more reliant on state funds than others. There are 182 local library jurisdictions that receive some state funds, of which 17 get more than 10 percent of their total funding from the state (and another 46 get more than five percent of their total funding from the state). Those local libraries that receive a greater share of their funding from the state rely on state support heavily and may be forced to close or take drastic measures (such as charging patrons for book loans) if they lose state funding.

Higher Education

BACKGROUND:

California's public higher education system involves three "segments": the University of California, the California State University, and the California Community Colleges (CCC). It also includes the Hastings College of the Law. The state's Master Plan for Higher Education, originally adopted in 1960, ascribes distinct missions to each of the segments and expresses a set of general policies for higher education in the state, including the state's intent that higher education remain accessible, affordable, high-quality, and accountable.

University of California (UC)

Drawing from the top 12.5 percent of the state's high school graduates, the UC educates approximately 237,800 undergraduate and graduate students at its ten campuses and is the primary institution authorized to independently award doctoral degrees and professional degrees in law, medicine, business, dentistry, veterinary medicine, and other programs. UC manages one U.S. Department of Energy national laboratory, partners with private industry to manage two others, and operates five medical centers that support the clinical teaching programs of the UC's medical and health sciences schools and handle more than 3.8 million patient visits each year.

California State University (CSU)

Drawing students from the top one-third of the state's high school graduates, as well as transfer students who have successfully completed specified college work, the CSU provides undergraduate and graduate instruction through master's degrees and independently awards doctoral degrees in education, nursing practice, and physical therapy, or jointly with UC or private institutions in other fields of study. With 23 campuses and approximately 412,000 students, the CSU is the largest and most diverse university system in the country. It also is one of the most affordable. The CSU plays a critical role in preparing the workforce of California.

California Community Colleges (CCC)

The CCC are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.6 million students. The CCC system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 71 educational centers. In addition to providing education, training, and services, the CCC contributes to continuous workforce improvement. The CCC also provides remedial instruction for adults across the state through basic skills courses and adult non-credit instruction.

Hastings College of the Law (Hastings)

Hastings was founded in 1878 and on March 26, 1878, the Legislature provided for affiliation with the UC. Hastings is the oldest law school and one of the largest public law schools in the

West. Its mission is to provide an academic program of the highest quality, based upon scholarship, teaching, and research, to a diverse student body of approximately 1,150 students.

Higher Education Funding

From 2008-09 through 2011-12, the state reduced funding for UC, CSU, CCC, and Hastings by $2.65 billion General Fund (as illustrated in Figure 1 below). The most notable consequences of these reductions have been significant student tuition fee increases (as illustrated in Figure 2 on the next page) and declining course offerings, which have made it difficult for students to complete their certifications and degrees in a timely manner.

Figure 1 – Higher Education Core Funding (dollars in millions)

		2007-08 Actual	2008-09 Actual	2009-10 Actual	2010-11 Actual	2011-12 Revised	2012-13 Proposed
UC	GF[1]	$3,257.4	$2,418.3	$2,591.2	$2,910.7	$2,273.6	$2,570.8
	Net Tuition[2]	1,365.3	1,437.4	1,751.4	1,793.1	2,403.7	2,444.1
	ARRA		716.5		106.6		
	Lottery	25.5	24.9	26.1	27.0	32.9	32.9
	subtotal [1]	**4,648.2**	**4,597.1**	**4,368.6**	**4,837.3**	**4,710.2**	**5,047.8**
CSU	GF[1]	2,970.6	2,155.3	2,345.7	2,577.6	2,002.7	2,200.4
	Net Tuition[2]	1,045.8	1,239.3	1,351.7	1,362.4	1,626.0	1,626.0
	ARRA		716.5		106.6		
	Lottery	58.1	42.1	42.4	42.4	47.8	47.8
	subtotal [1]	**4,074.5**	**4,153.2**	**3,739.9**	**4,089.1**	**3,676.5**	**3,874.3**
CCC	GF	4,272.2	3,975.7	3,735.3	3,994.0	3,276.7	3,740.2
	Fees	281.4	302.7	353.6	316.9	353.9	359.2
	LPT	1,970.8	2,028.8	1,992.6	1,959.3	2,107.3	2,101.1
	ARRA			35.0	4.0	0.0	
	Lottery	168.7	148.7	163.0	172.8	178.6	178.6
	subtotal	**6,693.1**	**6,455.9**	**6,279.6**	**6,447.0**	**5,916.4**	**6,379.0**
Hastings	GF[1]	10.6	10.1	8.3	8.4	6.9	8.8
	Net Tuition[2]	21.6	26.6	30.7	36.8	36.5	34.8
	Lottery	0.1	0.1	0.1	0.2	0.2	0.2
	subtotal [1]	**32.3**	**36.8**	**39.1**	**45.3**	**43.6**	**43.8**
GRAND TOTALS		**$15,448.0**	**$15,243.1**	**$14,427.2**	**$15,418.7**	**$14,346.8**	**$15,344.9**
	GF	10,510.8	8,559.4	8,680.5	9,490.7	7,559.9	8,520.2
	Fees/Tuition	2,714.1	3,006.1	3,487.3	3,509.2	4,420.1	4,464.1
	ARRA	0.0	1,433.0	35.0	217.2	0.0	0.0
	LPT	1,970.8	2,028.8	1,992.6	1,959.3	2,107.3	2,101.1
	Lottery	252.4	215.8	231.7	242.4	259.5	259.5

[1]2012-13 amount includes GO bond debt service.

[2]Includes systemwide and nonresident tuition and fee revenues less amounts redirected to institutional financial aid programs.

Figure 2 – Higher Education Annual Tuition Fees

Full-Time Resident Students	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13*	Change from 2007-08 Amount	Change from 2007-08 Percent
University of California								
Undergraduate	$ 6,636	$ 7,126	8,373**	$ 10,302	$ 12,192	$ 12,192	$ 5,556	84%
Graduate	7,440	7,986	8,847	10,302	12,192	12,192	$ 4,752	64%
California State University								
Undergraduate	2,772	3,048	4,026	4,440**	5,472	5,472	$ 2,700	97%
Teacher credential	3,216	3,540	4,674	5,154**	6,348	6,348	$ 3,132	97%
Graduate	3,414	3,756	4,962	5,472**	6,738	6,738	$ 3,324	97%
Doctoral	7,380	7,926	8,676	9,546	10,500	10,500	$ 3,120	42%
California Community Colleges	600	600	780	780	1,080	1,380	$ 780	130%
Hastings College of the Law	21,303	26,003	29,383	36,000	37,747	43,486	$ 22,183	104%

*Proposed
**Amount reflects full effect of mid-year increase.

GOVERNOR'S PROPOSAL:

The Administration presents a long-term plan for higher education rooted in the belief that higher education should be affordable and student success can be improved. The Administration proposes stable and increasing state funding to higher education and provides fiscal incentives to improve management of all expenditures. The significant components of the long-term plan include the following:

1. *Affordability*. The plan will curtail tuition fee increases and will lessen the pressure for students to take out loans.
2. *Student Success*. The plan will make annual General Fund augmentations contingent upon each institution achieving the Administration's priorities, including improvements in specific accountability metrics, such as graduation rates, time to completion, transfer students enrolled, faculty teaching workload, and, for community colleges, successful credit and basic skills course completion.
3. *Stable Funding Source*. The state will increase its General Fund contribution to each institution's prior year base by a minimum of four percent per year, from 2013-14 through 2015-16, contingent upon the passage of the Governor's tax initiative in November 2012.
4. *Fiscal Incentives*. The state currently budgets separately for, and adjusts annually, retirement program contributions and general obligation and lease revenue bond debt service for higher education capital improvement projects. The budget proposes to move these appropriations into each segment's base budget (except retirement program and general obligation bond debt service for the CCC) in 2012-13. The budget further states that no augmentations for these purposes will be provided in 2013-14, and beyond, to encourage the segments to factor these costs into their overall fiscal outlook and decision-making process.

Consistent with the above principles – to move all segment-specific costs onto the segments' base budgets and to provide the maximum flexibility to the segments – the budget includes the following segment-specific adjustments and proposals:

University of California

- $90 million increase for base operating costs, which the Administration indicates can be used to address costs related to retirement program contributions.
- $5.2 million increase for retired annuitant benefits.
- $206.6 million increase to move capital outlay debt service costs into UC's base budget.
- Eliminates budget bill language earmarking funds for specific programs and purposes, such as the Charles R. Drew Medical Program, AIDS research, and the California State Summer School in Mathematics and Science (COSMOS).
- "Trigger" reduction of $200 million, effective January 1, 2013, if the Governor's tax initiative is rejected by the voters.

California State University

- Decreases CSU's employer contribution to CalPERS by $38.5 million due to lower employer contribution rates. CSU's base budget includes a total of $404 million for the required CalPERS employer contribution.
- $1.1 million increase for retired annuitant benefits.
- $195.3 million increase to move capital outlay debt service costs into CSU's base budget.
- Eliminates budget bill language earmarking funds for specific programs and purposes, such as the Science and Math Teacher Initiative and nursing enrollments.
- "Trigger" reduction of $200 million, effective January 1, 2013, if the Governor's tax initiative is rejected by the voters.

California Community Colleges

- Reduces 2011-12 apportionment funding by $146.9 million to reflect an identical increase in offsetting property taxes available to community college districts resulting from the recent Supreme Court decision on redevelopment agencies.
- $218.3 million increase to partially pay off apportionment funding that had been previously deferred, contingent upon passage of the Governor's tax initiative. This action would reduce the total of the inter-year deferral from $961 million to $743 million.
- $109.4 million increase to backfill a fee revenue shortfall.
- Consolidates nearly all categorical programs (total of $411.6 million) and provides flexibility to community college districts to use the "flexed" categorical funds for any general operating cost.
- Eliminates 13 mandates deemed unnecessary, suspends five others, and maintains four mandates related to enrollment fees and financial aid. With regard to the five suspended mandates, funds a $22 million "block grant incentive program" to incent continued compliance with the previously mandated activities. For the four retained mandates, *continues* to offset any costs incurred by districts through the categorical funding allocation. Note, K-14 mandate reform is discussed in greater detail in the K-12 Mandates section of this report.
- Specifies that CCC funding in 2012-13 will be allocated to districts on the same proportionate share that districts received in 2011-12; states that the CCC Chancellor's Office may deviate from this methodology if it develops an alternative methodology that is approved by the Board of Governors and Department of Finance.

- Should the Governor's tax initiative be rejected by the voters, the CCC budget would be reduced as part of an overall $4.8 billion K-14 Proposition 98 reduction, as follows: (1) $218.3 million in apportionment funding would again be deferred (returning the total inter-year deferral to $961 million) and (2) $292 million programmatic reduction ($262 million of which is related to moving K-14 general obligation debt service into Proposition 98, which is discussed further in the K-12 section of this report).

Hastings College of the Law

- $1.8 million increase to move capital outlay debt service costs into Hastings' base budget.

ISSUES TO CONSIDER:

Overall Theme to Higher Education Budget. At a 1,000 foot level, the Administration is proposing to reform the higher education funding model across the segments. First, the Administration proposes to "reset" the higher education budgets with most costs included and, via a "block grant" approach, provide the funding with significant new flexibility in 2012-13. Then, beginning in 2013-14 and contingent upon passage of the Governor's tax initiative, the Administration proposes a "long-term funding agreement" through 2015-16 that increases each segment's base by a minimum of four percent per year if the segment achieves the Administration's priorities. While the operational specifics vary by segment, and many aspects of the Administration's proposal remain undefined (such as the accountability metrics) or under-defined (such as the mechanics of the "reformed" CCC budget), the overall approach presents a number of broad questions for the Legislature to consider as outlined below.

This is the New "Normal." In many respects, the budget acknowledges the reality of what has happened to not only the state, but the segmental, budgets in recent years. Akin to the state's overall resources dramatically decreasing in recent years, so have the General Fund resources available to higher education. Whether we want to acknowledge it or not, the budget is the new normal. There is no likely current scenario whereby $2 billion plus General Fund is going to materialize to restore the segments' budgets. Rather, after years of significant state funding reductions, the Governor is resetting the segments' budgets to their current workload and, by providing increased autonomy and flexibility, directing the segments to do the best they can to manage their budgetary demands from within those resources. This raises a key question: If this is the funding level that the state can afford for higher education, what does the Legislature expect the segments to achieve? This is also a question that the segments and their governing boards should be considering as they review the budget.

Budgetary Impacts in 2012-13 Versus Future Years. Broken down, the budget contains the following parts: (1) basically flat year-to-year funding for higher education in 2012-13; (2) removal of budgetary strings including earmarks and enrollment targets for UC and CSU, and categorical and mandate reform and a new allocation methodology for the community colleges, in 2012-13; and (3) increased funding in 2013-14 through 2015-16, contingent upon voter approval of the Governor's tax initiative and segment performance on yet-to-be defined accountability metrics. The budget presents these three items as one set of actions, but that is not the operational reality. While the first and second items occur with the adoption of the budget, the third is a complete unknown, not only from the standpoint of election outcomes but also to the specifics of the Administration's performance metrics. Further, one Legislature cannot ties the hands of another; at best, any budget decision made this year about 2013-14 or beyond is a statement of legislative intent. This raises two key questions: (1) Does the Legislature want to move toward granting more flexibility/autonomy to the segments (perhaps accompanied by increased accountability measures)? (2) Does the Legislature want to commit to out-year budget increases?

The State Lacks a Higher Education Oversight Structure. In 2011, the Governor vetoed funding for the California Postsecondary Education Commission (CPEC), citing the agency's ineffectiveness in higher education oversight. In light of this action, the future of higher education oversight remains unclear. While the public segments have stepped in to assume some roles previously performed by CPEC, there are concerns about how institutional and public interests will be balanced. In its January 6, 2012, report entitled, "*Improving Higher Education Oversight*," the LAO focused on the need for oversight that enables policymakers and others to monitor how efficiently and effectively the postsecondary system is serving the state's needs, and make changes to improve its performance. The specific recommendations of that report include that the Legislature: (1) define the state's postsecondary education needs, such as setting specific goals; (2) use performance results to inform policy decisions; and (3) establish an independent oversight body with limited and clear responsibilities.

Noting the difficulty of creating a new public organization in the current fiscal environment, the LAO offered a number of short-term measures to strengthen oversight in the interim: (1) amending statute to ensure pertinent data remain available to policymakers and researchers; (2) increasing direct legislative oversight and limiting new long-term funding commitments until an effective oversight structure is in place to support the legislature's decision-making; and (3) monitoring segments' allocation decisions, including investment in new programs and other major program changes, until mechanisms are in place for outcome review. The absence of a CPEC, as well as any defined set of mutually agreed upon goals for the state and its higher education system, raise another question about the budget: What is the Legislature's role here; e.g., what role should the Legislature play, if any, in determining the outcomes and the metrics used to measure performance of the segments?

The Segments Will Likely Budget as if the "Trigger" Cuts Will Happen. Should the voters reject the Governor's tax initiative, the "trigger" reductions for UC and CSU total $200 million each. For the CCC, $218.3 million in apportionment funding would again be deferred and there would be a $292 million programmatic reduction. All of these reductions would come at the end of the fall semester, making the reductions so disruptive that the segments likely would feel compelled to adopt budgets assuming the reductions will happen. This is largely the approach taken in 2011-12, as the budget contained trigger reductions based on revenue assumptions that did not subsequently materialize. In January 2012, UC and CSU were cut by $100 million each; the CCC by $102 million. The segments generally included these "worst case scenario" cuts in their budget planning so as to avoid dramatic mid-year cuts. However, taking the same approach in 2012-13 will be even more challenging for the segments. Since 2008-09, the state has reduced funding for UC, CSU, CCC, and Hastings by $2.65 billion General Fund. Therefore, after years of reduced state funding, it is appropriate to question what budgetary levers remain for the segments in planning for further reductions. This question is especially crucial in light of the budget proposal to cede autonomy to the segments, including allowing UC or CSU to set their own enrollment targets. In the absence of these types of controls or goals on the state level, a potential scenario is that enrollments could be severely curtailed, disproportionately impacting the transfer of community college students to UC and CSU which is a long-identified state priority.

A New Approach to Financing UC and CSU Capital Outlay. The budget adjusts UC and CSU budgets for capital outlay debt service costs and proposes no future adjustments. In the future, the state would presumably still issue bonds, but covering the debt service costs associated with those bonds would be a question for UC and CSU to consider in light of the available resources in their base budgets. Some of the details of this proposal remain unclear, including what, if any, budget trailer bill language the Administration will propose as well as applicability of the new approach to lease-revenue bonds versus general obligation bonds. It is also unclear if UC and CSU would be required to seek Administration and legislative approval for specific projects in future years.

Regardless of these unknowns, this approach is a departure from how UC and CSU capital outlay has been historically addressed. Under the current system, and in the last ten years, the LAO reports that the state spent an estimated $10.1 billion on higher education infrastructure; 80 percent of that support came from general obligation bonds and an additional 19 percent from lease-revenue bonds. Associated higher education debt-service costs more than doubled during this same time period, from about $516 million in 2000-01 to an estimated $1.1 billion in 2010-11. Most of the general obligation bond spending was from bonds approved by the voters in 1998, 2002, 2004, and 2006. In general, the state provides less funding for higher education projects when the balance of general obligation bonds is exhausted. In the case of UC and CSU, the state has typically offset some of this reduction by funding some projects with lease-revenue bonds. In contrast, the community colleges have not pursued lease-revenue bonds in recent years because repayment counts toward their Proposition 98 funding allotment (and therefore comes at the expense of other CCC programs).

This new approach to capital outlay for UC and CSU raises several questions for the Legislature to consider, including: (1) Is the 2012-13 funding provided adequate to annually service the segments' existing bond debt in the coming years? (2) Is the proposed total base funding (which could grow by four percent annually) reasonable to cover the UC and CSU various operational and bond-related costs? (3) Are the universities in the best position to determine how much of their base budgets to devote to capital and non-capital costs? (4) To what extent, and in what ways, will the Legislature have a say in the segments' commitment of General Fund support toward capital projects?

UC and the University of California Retirement System (UCRP). From 1990 to 2010, UC and its employees enjoyed a two-decade pension funding holiday due to: (1) substantial overfunding of UCRP during the 1980s by the state and UC (and its employees) and (2) very strong investment returns for UCRP during the 1980s and 1990s. The state also benefited from the holiday, since it had contributed to UCRP in prior decades and used the elimination of contributions as a budget solution during the fiscal crisis of the early 1990s. During the contribution holiday, UC continued to add employees and provide additional service credit to existing employees – making it impossible for the holiday to continue forever. The investment market downturn of 2008 caused the already dwindling surplus to fade away and UCRP now has an unfunded liability. In the past several years, UC has reinstituted employee and employer contributions and repeatedly sought additional state funding so it can cover normal costs and retire unfunded liabilities over the next several decades. To date, and despite UC's requests, the Legislature has chosen not to provide additional funding to UC for this purpose. UC projects that total state costs would peak at around $400 million plus.

The LAO has highlighted that these pension costs are real obligations that need to be paid, and it is reasonable for the state to cover the retirement costs of UC's state-funded employees, just as it does for other agencies. One over-arching challenge is that it is not clear what the "state share" should be given that UC also has non-state funded employees (such as through federal funds or patient revenues at the academic medical centers). There are also questions about what legal obligations the Legislature could incur by restarting contributions. Therefore, the LAO has advised that the Legislature proceed with caution and not simply pay whatever bill UC presents, given that UC (rather than the state) controls its pension costs and sets benefits levels for its employees; i.e., the state may choose to re-start state contributions to UC under the right conditions.

As discussed in greater detail in the higher education section of this report, the budget includes a $90 million base budget augmentation which the Administration indicates "can be used to address costs related to retirement program contributions." That these funds are not directly tied to retirement program contributions is indicative of issues identified above by the LAO. In considering the Administration's approach, the Legislature may want to clarify how any such augmentation could be construed. For example, under one view, the $90 million is a budget backfill for internal shifts and/or reductions that have already been implemented in light of the fact that UC restarted employer contributions to UCRP several years ago. In the alternative, the $90 million could also be viewed as representing new state costs (in 2012-13).

CSU Retirement Costs. The budget proposes to adjust CSU's budget one last time for retirement costs, including its required employer contribution to CalPERS and for retired annuitant health benefits. These costs, and any future adjustments, would then be covered from within CSU's base budget; i.e., the state General Fund would no longer account for the annual adjustment, be it a cost increase or a cost decrease. Per the "funding agreement" and contingent on CSU's performance on specific metrics, CSU's base budget could grow but these retirement costs would be covered from within the base budget.

By bringing these costs onto CSU's base budget, the Administration intends for CSU to consider them in its budget and fiscal outlook; in essence, the Administration is trying to incent CSU to operate efficiently and effectively and balance all of its needs within its budget. From CSU's perspective, this approach adds costs that have been historically covered by the state budget and, further, is not completely within the employer's control. For instance, the CalPERS Board sets the employer contribution rate. But this is not unique to CSU as an employer; this also applies to the state as well as every other public employer who contracts with CalPERS. Employee pension contributions are negotiable; however, as the LAO has reported, there are strict legal protections that limit government's flexibility to impose increased employee contributions. Rather, for many current employees such contribution increases would be implemented only through negotiations, and in any event, would result in many employers providing comparable offsetting advantages, such as increasing pay or other compensation, to offset the financial effect of the higher pension contributions. This would tend to erode any savings from increased employee pension contributions.

Given that the state does not collectively bargain with CSU employees (note, the 2010 reforms described above pertaining to reduced pension benefits for new hires effective January 15, 2011, includes new CSU hires as of that date), the Administration has identified a valid issue with CSU and its management of its retirement costs – whether the state General Fund should continue to cover changes in CSU's retirement-related costs beyond the amount provided in the base budget. However, if the budget proposal is not the "right" approach, the Legislature may wish to consider other possible approaches and what changes might be needed to implement those other approaches.

Early Action Requested on CCC Local Property Taxes. The budget reduces 2011-12 apportionment funding by $147 million to offset for increased property tax revenues available to districts due to the elimination of redevelopment agencies. The Administration has requested early action on this adjustment – by March 2012 – to ensure the savings can be achieved. However, the reliability of the estimate is unclear. This is an important consideration for the CCC, as unlike K-12 education, the CCC do not receive an automatic General Fund backfill if local property tax revenue falls short of budget expectations. Therefore, should the $147 million in increased local property taxes not materialize, and absent a proactive action to backfill the CCC budget with General Fund, the CCC would face a current year funding shortfall on top of $102 million in "trigger" cuts they absorbed in January 2012.

Change in Allocation Methodology for CCC Districts. As noted earlier in this section, many aspects of the Administration's proposal remain undefined or under-defined. This is particularly true with the proposed changes to the CCC budget. This is, in part, a function of the budget process. Proposed budget trailer bill language is not due to the Legislature until February 1 of each year and implementation of many of the CCC proposals would require trailer bill language. Not having this detail available now creates challenges to gaining a full understanding of the CCC budget reforms. However, some details have been conveyed. For instance, the Administration indicates that the reforms to the categorical and mandate programs are proposed regardless of any election outcome this fall. In addition, the budget bill requires that 2012-13 district-level apportionment funding be allocated in the same proportion as districts received in 2011-12, regardless of any changes such as in enrollment at the district level, unless the CCC Chancellor's Office develops an entirely new methodology for allocating district-level funding.

In directing this use of the 2011-12 methodology, the budget bill eliminates the historical model, which is dictated in statute and allocates funding on a full-time-equivalent student (FTES) basis. The yet-to-be-developed alternative methodology would be subject to the approval of the Department of Finance before it could be utilized. While it would theoretically be an option for the Chancellor's Office to conclude that retention of the current model is the best approach, is that outcome even possible given that the budget rejected that model. In addition, while the overall approach is consistent with the Administration's intent to provide maximum flexibility (similar to UC and CSU), and the CCC are a higher education system, the CCC have a K-12 governance structure with 72 local districts, each with its own elected board members. In addition, there are separate statutory requirements dictating expenditure levels on faculty salaries and the percentage of full-time versus part-time faculty. It is not readily clear how the UC and CSU model can apply to the CCC reality without major structural and statutory changes, some of which would take significant time to implement. Further, the budget does not provide a role for the Legislature in approving the alternative funding methodology should it be developed by the Chancellor's Office.

CCC Student Success Task Force (SSTF). Chapter 409, Statutes of 2010 (SB 1143; Liu), required the CCC Board of Governors (BOG) to establish a task force to examine best practices for promoting student completion and adopt a plan for improving student success rates within the CCC. After a year of fact finding, deliberation, and public engagement, the SSTF finalized its recommendations and submitted them to the BOG in January 2012. The recommendations were subsequently adopted by the BOG and, per Chapter 409, will be reported to the Legislature at a joint hearing of the Senate Education and Assembly Higher Education Committees on or before March 1, 2012. With these actions, the conversation will effectively move from "what" recommendations to "how" the recommendations are implemented, as the SSTF's work has resulted in a thorough set of recommendations that warrant legislative consideration.

There is, however, an interesting juxtaposition between the SSTF recommendations and the Governor's CCC budget reforms. While there is some overlap between the SSTF recommendations and the budget reforms (such as granting the Chancellor authority to allocate apportionment funding differently), other SSTF recommendations address issues not identified in the budget reforms (such as adopting new systemwide enrollment priorities and strengthening BOG waiver requirements), and some of the budget reforms go well beyond the SSTF recommendations (such as with regard to categorical reform). As noted above, the budget also eliminates the current funding model and provides increased autonomy and flexibility, but in so doing effectively removes many of the tools the Legislature would ostensibly use to address its concerns that prompted passage of Chapter 409. Given the extensive intersections between the SSTF recommendations and the Administration's budget reforms, careful legislative consideration is warranted of all proposals.

SUBCOMMITTEE NO. 2

NATURAL RESOURCES, ENVIRONMENTAL PROTECTION, ENERGY, and TRANSPORTATION

Natural Resources

Transportation

AB 32 and Cap and Trade Funding

BACKGROUND:

The California Air Resources Board (ARB), along with 35 local air pollution control and air quality management districts, protects the state's air quality. The local air districts regulate stationary sources of pollution and prepare local implementation plans to achieve compliance with federal and state standards. The ARB is responsible primarily for the regulation of mobile sources of pollution, greenhouse gas emissions (GHG), and for the review of local district programs and plans.

AB 32 establishes greenhouse gas reduction levels. Assembly Bill 32, enacted in 2006, established the goal of reducing statewide GHG emissions in California to 1990 levels by 2020. It also charged the ARB with monitoring and regulating the state's sources of GHGs and identified a timeline by which ARB is to complete specified AB 32-related implementation actions. This included developing a scoping plan encompassing a set of measures that, taken together, would enable the state to achieve its 2020 GHG-reduction target. The scoping plan's measures include a combination of direct regulations and mandated requirements affecting energy efficiency and consumption, along with actions to provide price incentives for energy efficiency and GHG reductions.

Cap and Trade One of Many CO2 Emission Reduction Measures

The state's overall goal for GHG emission reductions is the 1990 level of 427 million metric tons of carbon dioxide equivalents (MMT). The Cap and Trade program sets a statewide limit on the sources of greenhouse gases (GHGs) responsible for 85 percent of California GHG emissions. Under the cap and trade system, the ARB sets a cap on the amount of emissions (pollution) will be allowed. After that, the ARB issues credits (license or permit to emit the pollutant), most of which are issued for free. The California Public Utilities Commission (CPUC) also will be issuing credits under this plan to the Investor Owned Utilities and has started a rulemaking proceeding for the expenditure of any proceeds. The number of credits issued establishes the level a given company may pollute. A certain amount of credits are held back to be sold. Finally, if a company pollutes under its cap, it may trade or sell its credits. If it needs to pollute over its cap, it must buy credits. Essentially, cap and trade programs establish a financial incentive for long-term investments by assessing a cost to emit a GHG. As shown in the following figure, the scoping plan estimates that cap and trade will create approximately 23 percent of the reductions needed to meet the state's reduction goals.

Scoping Plan's Greenhouse Gas (GHG) Emissions Reduction Measures

GHG Emissions in millions of metric tons of carbon dioxide equivalents.

Category of Measure [a]	2010 Analysis Target Reductions	Percent of total
Low carbon fuel standard	15	19%
High global warming potential gases [b]	6.5	8
Energy efficiency	12	15
Renewables portfolio standard (33 percent RPS) [b]	11.4	14
Pavley standards [c]	3.8	5
Other measures [b]	13.3	16
Cap-and-trade	18	23
Total	**80**	**100**

a) Source: Legislative Analyst's Office

b) Target excludes measures under this category which have not been updated for 2010 from 2008, and therefore does not reflect all measures contained in the 2008 Scoping Plan.

c) The Pavley standard refers to the state's fuel economy regulations, which are broken into two rules known as Pavley 1 and Pavley 2.

GOVERNOR'S PROPOSAL:

Governor's budget includes regulation and programs for GHG reductions. The Governor's budget includes funding for GHG reduction programs in multiple state agencies. Most of the programmatic activity is hosted at the ARB and state energy agencies including the California Public Utilities Commission. This is because ARB is charged with monitoring and regulating GHG emissions while CPUC and the Energy Commission (CEC) are charged with monitoring one of the largest sources of GHG emissions, the energy sector.

Annually, the Administration submits a cross-cut budget to help the Legislature evaluate its AB 32 activities, both compliance and direct regulation. In May 2011, the ARB submitted a required zero-based budget that detailed expenditures in each agency, complete with programmatic information and positions. A total of 181 positions and about $36 million are dedicated to AB 32 activities across state government in the budget. This does not include overlapping positions at the energy agencies that work on related programs. For example, the state has an existing law, the renewable portfolio standard (RPS), which mandates levels of renewable energy sources the state's energy sector may use. The goals of the RPS complement GHG reduction but the primary focus of this law is the reduction of traditional sources of pollution such as reduced dependence on coal-fired energy.

AB 32 Cross-Cut Budget [a]
(dollars in thousands)

Department	Fund Source	2011-12	2012-13	Total Positions
Secretary for Environmental Protection	AB 32 Cost of Implementation (COI) Fee	$1,821	$586	4
Department of General Services	Service Revolving Fund	416	416	5
Department of Housing and Community Development	AB 32 COI Fee	98	98	1
California Energy Commission	Energy Resources Program Account	590	590	5
Department of Resources Recycling and Recovery	AB 32 COI Fee	501	496	6
Department of Water Resources	State Water Project Funds/ AB 32 COI Fee	551	316	3
Air Resources Board (includes development of cap-and-trade regulations)	AB 32 COI Fee	32,932	32,932	155
State Water Resources Control Board	AB 32 COI Fee	535	555	2
Department of Public Health	AB 32 COI Fee	314	348	0
Subtotal AB 32 Cost of Implementation Fee		**$37,758**	**$36,337**	181
Unknown/Undetermined	Cap-and-Trade Revenues		Up to $1 billion	Unknown
California Public Utilities Commission	Cap-and-Trade Revenues		Unknown	Unknown

a) Does not include complementary programs such as RPS activities at the energy agencies.

Cap-and-Trade fee revenues are included in the budget. The ARB plans to begin auctioning GHG emission allowances as part of its market-based compliance measures in 2012. The ARB estimates that fee revenues from the first set of auctions will be $1 billion in the first year of the program which is included in the budget. These auction revenue estimates vary widely making specific budget expenditures uncertain. Actual revenues are not anticipated to be certified until late in 2012-13. A General Fund offset of $500 million is also included in the budget; however, there is no specific proposal for this expenditure. Rather than a detailed budget proposal, the budget provides general categories of spending from the proceeds of the auctions. These include:

- Clean and efficient energy
- Low-carbon transportation
- Natural resource protection

- Sustainable infrastructure development.

30-Day notification to the Legislature planned for expenditures. The budget provides that an expenditure plan for both the $500 million General Fund offset as well as the $1 billion will be jointly submitted by the Director of Finance and the Air Resources Board. The plan must include specific expenditure and will allow the Legislature not fewer than 30 days to review the plan before allocation of funding will begin.

ISSUES TO CONSIDER:

Planned emission reductions from Cap and Trade Program were adjusted downward. The role for cap-and-trade to fill the gap between the total target and the emission reductions planned from traditional command and control measures have been reduced. The 2008 Scoping Plan initially was expected to provide 34.4 MMT of carbon dioxide equivalent reductions. Revised expectations in 2010 now show a reduction of 18 MMT of emission reductions proposed from cap-and-trade. The majority of reductions will be from traditional command and control measures including to some extent existing programs in renewable energy investment and clean car standards. According to the Legislative Analyst's Office, these figures are still likely overstated because the board has not comprehensively scored the emission reductions planned to come from other complementary measures.

Cap and Trade Program is complex and subject to potential gaming of the system. Carbon markets are, by their very nature, complex. In general, the more complex the markets are, the more susceptible they become to manipulation and fraudulent activity. The cap and trade program as designed by ARB is particularly complex in that it has a multitude of design features that are intended to address various policy objectives. These policy objectives include the ARB's desire to reduce the potential for economic activity to leave the state as a result of the program implementation. In addition to this, there is no national or state oversight agency to monitor and regulate trading of compliance instruments on the spot market.

30-Day Notification means short review and little oversight of potentially $1 billion in new program spending and budget backfills. The Governor's proposal provides the Legislature with a 30-day notification to expend funds from the auction proceeds. The auction of carbon credits is highly speculative—with estimates ranging from $350 million to over $1 billion revenues in the first year. This notification would be the first time Legislators would see the Governor's detailed expenditure plan. There is no detail provided in the budget indicating specifically where funding would be directed from the proceeds, what types of grant or loan programs would be created, or what state programs would be offset. Legislative oversight of the funds related to fee nexus, GHG emission reduction achievement, and overall program selection would be extremely shortened under the Governor's plan.

Resources and Water Bonds

BACKGROUND:

$21.8 billion in resources bonds have been approved since 1996. These General Obligation bond funds represent the majority of non-State Water Project infrastructure investment in the Resources and Environmental Protection arena during this time period. Infrastructure spending covers a wide array of programs and projects including for:

- Water-related local assistance;
- Land and wildlife conservation;
- Parks and recreation;
- State flood control capital outlay; and,
- Forestry and fire protection.

Many resources programs and local infrastructure projects rely on state general obligation bond funds. For example, state conservancies rely nearly 95 percent on bond funds with some supplemental operating funding from either the General Fund or Environmental License Plate Fund. Bond funds have also been a major source of local assistance grant programs including for local parks, regional water supply, and regional conservation efforts. Over two-fifths of state spending on resources infrastructure of the last decade was for local assistance, with that amount funded almost entirely from general obligation bonds.

Natural Resources and Environmental Protection General Obligation Bonds (dollars in millions)

Bond	Year	Allocation	Obligated Funds	Balance (July 2012)	Proposed [a)]
Proposition 204	1996	$870	$837	$32	$1
Proposition 12	2000	2,100	2,077	16	15
Proposition 13	2000	2,095	1,876	205	11
Proposition 40	2002	2,600	2,544	9	37.5
Proposition 50	2002	3,440	3,368	22	70
Proposition 1B	2006	1,200	892	26	n/a
Proposition 1E	2006	4,090	2,590	1,205	63
Proposition 84	2006	5,388	4,034	873	837
Total		**$21,783**	**$18,218**	**$2,388**	**$10,345**

a) Estimates pending adjustments in April with the release of the forthcoming Infrastructure Plan.

$11.1 billion water bond proposed for November 2012 ballot. In 2010, the Legislature approved the Safe, Clean, and Reliable Drinking Water Supply Act of 2012, an $11.1 billion bond measure mainly for state and local water projects. The bond originally was to appear on the November 2010 ballot; however the Legislature voted to postpone the measure until the November 6, 2012 ballot. The bond includes a mixture of local assistance and statewide water management projects. A portion of the bond is to be used for conservation projects largely unrelated to water supply or water quality.

Proposed Water Bond (in millions)

Category	Allocation
Drought Relief	455
Integrated Regional Water Management	1,400
Delta Sustainability (public benefits)	2,250
Statewide Water System Operational Improvement	3,000
Conservation and Watershed Protection	1,785
Groundwater Protection and Water Quality	1,000
Desalination and Water Recycling	1,000
Water Conservation	250
Total	**11,140**

GOVERNOR'S PROPOSAL:

Governor plans to release five-year infrastructure plan. The Governor proposes about $10.3 million in new bond appropriations in the budget. This is a significant increase from the previous year's budget proposal and reflects the varying amount of bond funds available for programs and projects. Because the Governor plans to submit his five-year infrastructure plan, the amounts reflected here are estimates and are likely to be adjusted in April. Much of the water-related funding available is for flood control capital outlay from Proposition 1E with lesser amounts available for integrated regional water management ($505 million), various water projects including those in the Bay-Delta ($205 million), safe drinking water ($140 million), and State Parks ($63 million).

A significant amount of bond funds have been appropriated by the Legislature that are in the process of being expended over the next several years. For the majority of these projects, bonds have not been sold on the market, meaning that we are not incurring debt service as yet. For at least $3 billion, however, bonds have been sold, the projects have yet to start, and the state is paying debt service for the projects.

ISSUES TO CONSIDER:

Debt-Service Ratio (DSR) Expected to Rise. Voters have authorized close to $20 billion in general obligation bonds for resources since 2000. Unlike bond measures issued in prior decades, recent bond measures have been larger (typically several billion dollars) and wider in scope (covering a broad array of resources issues). The large bond measures have increased state debt-service expenditures considerably. The current year budget included almost $1 billion from the General Fund to service resource-related general obligation bond debt. This amount reflects 46 percent of total General Fund expenditures in the resources area. In contrast, resources-related general obligation debt service represented eight percent of General Fund spending for resources programs in 2000-01. General Fund support for other priority programs is limited by the necessity to repay general obligation bond costs.

Debt service impacts cash management now more than ever. About one-third of the $10 billion in general obligation bond funds appropriated remain unspent. This is in part due to a change in the way the state issues bond debt. Up until recently, the Pooled Money Investment Board (PMIB) would approve interim loans (known as “AB 55 loans”) from the state’s pooled cash accounts to move capital outlay and similar grant-funded projects forward prior to the issuance of state bonds that would ultimately pay for the projects. However, since December 2008, the PMIB has essentially frozen AB 55 loan funding, in part due to the increasing needs of the General Fund to borrow from the pool due to the state’s cash flow and budget crises. This means that the cash to support bond appropriations must come from bond sales, meaning that the state is incurring debt-service costs earlier than it would when AB 55 loans were available.

Other options are available for some types of bond funded programs. General obligation bond funds are not required to be paid back by the General Fund. As an example, the State Water Project was passed as a General Obligation bond, with the full backing of the General Fund. However, nearly 96 percent of this bond issue has been paid back with fees paid by the users of the State Water Project, and further bonds necessary for the project have been similarly repaid by user fees. This allows the up-front need for capital to be issued while requiring only those who benefit from the project to incur the costs of the bond debt.

The Water Bond impacts the budget in a significant way. Debt service for resources bonds has increased annually from a low in 2001-02 of just under $200 million to over $700 million in 2009-10. The $11.1 billion water bond would add over $650 million in debt service over time to this figure resulting with no new revenue identified to pay for these programs and local assistance projects. Not all of this would occur within the first few years as the bond is scheduled to be issued over a longer time period.

Does the Water Bond address the most pressing needs of the state? The water bond was created to address multiple water needs from projects with statewide significance to local park conservation projects. There are many water-related infrastructure needs throughout the state, from local wastewater infrastructure to the state's levee system. As decisions are made in the Delta, projects will be necessary to execute the state's vision for future Delta water supply and reliability. The LAO has recommended that resources bond expenditures in the annual budget be well justified, reflect a clear programmatic need, be an appropriate funding source for the activity in question and reflect legislative priorities. They also recommend the use of the "Beneficiary Pays" funding principle for projects with direct benefits to project beneficiaries. All of these issues factor into questions about whether or not the current water bond addresses all of these issues or should it be modified to focus on only the highest pressing needs with a link to beneficiary pays where allowable.

Can we accelerate bonds to stimulate jobs? Most of the bond funding has been appropriated but much remains to be expended. Most of this funding is in the water arena, primarily flood and levee funding as well as some integrated regional water management local assistance funding. The administration has plans to expend the money and the Legislature may wish to be kept apprised of its efforts to move funding out the door quickly.

Parks Funding

BACKGROUND:

The Legislature approved two major reductions to the Department of Parks and Recreation in the 2011 budget. The first was a reduction of $11 million in the current year and a $22 million ongoing starting in this budget. To implement the reduction, the Legislature approved trailer bill language specifying criteria for reducing the state park system including how the administration can select parks for closure, partial, closure and reduced service. The Legislature also approved a reduction of $10 million to the Off-Highway Vehicle (OHV) program and a shift of the same amount from the Motor Vehicle Fuel account to the General Fund.

In May of 2011, the department submitted a list of 70 parks slated for closure to the Legislature and the public. Using the following criteria, parks were selected from all areas of the state:

- Relative significance (e.g., historic value, uniqueness)
- Rate of visitation
- Estimated net savings to each park unit
- Feasibility of closing the park
- Operating efficiencies to be gained
- Infrastructure deficiencies (such as septic repairs or costly building upgrades)
- Recent infrastructure investments and capital improvements
- Deed and grant restrictions
- Funding provided from non-General Fund sources (such as dedicated fees)

Shortly after the list of closures was released, the department produced its estimates of operating costs and capital improvement needs at the 70 parks slated for closure. The department does not budget on a park-by-park basis; therefore, it is difficult to determine the exact amount of money an individual park may save. This also makes it difficult for those who wish to take over the parks to determine how much funding is necessary to take over an individual park.

In the interim since the budget has passed, members of the public, local agencies, federal agencies, and non-profit organizations have made efforts to find other ways to fund parks on the closure list. For example, the National Parks System will charge two dollars more at Muir Woods to pay for continued operation of Samuel P. Taylor State Park which was slated for closure and to help support Mt. Tamalpais State Park which is not on the closure list. Mono Lake State Natural Reserve was also removed from the closure list because of efforts by local nonprofits to take over funding for the park through increased fees.

GOVERNOR'S PROPOSAL:

The Governor's proposal includes the final and ongoing $11 million General Fund reduction approved by the Legislature last year resulting in closure of *up to* 70 state parks effective July 1, 2012.

The budget proposes to shift $11 million from the base budget to a continuously appropriated fund to provide the department additional flexibility to implement new projects or programs that generate additional revenues. The department is also proposing to spend $4.3 million from this fund for revenue generating projects. This is tied closely to the department's efforts to provide incentives to individual park units while pursuing concessions, operating agreements, and other arrangements with public, nonprofit, and private entities to keep as many parks open as possible.

The budget also includes a ballot trigger reduction to eliminate all seasonal lifeguards and 20 percent of park rangers if the Governor's tax proposal is not approved in November. This will result in an additional $8.7 million ongoing reduction if fully implemented.

Major Sources of Funding (in thousands)

Funding Source	2011-12	2012-13	Comment
General Fund	$121,831	$112,015	Reflects General Fund reduction
State Parks and Recreation Fund	139,316	132,286	Reflects proposal to shift funds to non-budget act
Off Highway Vehicle Trust Fund	113,912	75,233	
Federal Trust Fund	28,116	16,175	
Bond Funds	688,774	28,308	Reflects reduction in one-time bond expenditures
All Other Funds	86,452	68,451	
Total	**$1,178,401**	**$432,468**	

ISSUES TO CONSIDER:

Funding shifts and funding increases mask a challenged budget environment. Over the past five years, the department has effectively shifted its main source of funding from the General Fund to the State Parks and Recreation Fund (SPRF). On paper, this means that the department's spending power has effectively remained the same between these two funding sources since 2008-09. In fact, with other sources of funding, the department's overall budget has grown from $367 million to $432 million. Even excluding one-time bond expenditures, the budget has grown about 18 percent in the past several years. Much of this growth can be attributed to other funding sources including increased reimbursements, increases in the Off-Highway Vehicle Trust Fund, and other dedicated funding sources for specific purposes.

State Parks and Recreation Funding 2008-09 to 2012-13
(dollars in thousands)

	2008-09	2009-10	2010-11	2011-12	2012-13
General Fund	$135,241	$120,720	$117,458	$121,831	$112,015
State Parks and Recreation Fund	111,596	118,080	114,339	139,316	132,286
Other Funds	94,679	127,286	130,313	228,480	159,859
Subtotal	**$341,516**	**$366,086**	**$362,110**	**$489,627**	**$404,160**
Bond Funds (One-Time)	26,192	40,542	116,243	688,774	28,308
Total (including bond funds)	**$367,708**	**$406,628**	**$478,353**	**$1,178,401**	**$432,468**

Parks infrastructure costs are increasing with an aging system. However, during the time of the budget increases, costs to run state parks have also increased. Many state parks are over 50 years old and have an aging infrastructure much like our state levees and wastewater infrastructures. Decades old septic systems designed for lower visitor usage are being put to the test and in many cases failing requiring more and more costly repairs to maintain. Additionally, as we increase fees for park visitors, those visitors expect amenities that are reflective of an increased cost to use the park. Even such basics as flushing toilets and garbage service have increased in cost.

One state park costing the state millions per year. As an example of increased costs, one state park, the Empire Mine State Park has cost the state $31 million over the past five years due to toxic runoff from the mining operation conducted there over 50 years ago. The park was a gold mine for 100 years before it closed in 1956. The state acquired the property in Grass Valley, California with more than 850 acres of forested land, mine buildings, and historic properties in 1975. The state park was the subject of a series of lawsuits and cleanup and abatement orders related to the park’s 367 miles of abandoned and flooded mine shafts and toxic legacy from gold mining. The rulings required the state to clean up toxic runoff from the gold mining legacy. The state has been in negotiations with the former owner over the cleanup since the orders were issued; however according to the latest budget proposal, mediation has stalled while cleanup is still required.

Empire Mine State Park Funding 2007-08 to 2012-13
(dollars in thousands)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
General Fund, Bond Funds and Special Funds	$3,868	$1,368	$5,765	$4,070	$11,595	$4,594
Total (all funds)						**$31,260**

How can the state maintain its current park system? The greatest question for legislators is what kind of state park system can the state maintain over the long term. Acquisitions over time whether through ballot approved bond measures or donations from individuals or groups have led the state to own and manage more property than can appropriately be budgeted for. Unexpected expenses such as the Empire Mine example and an increasingly aging system have backlogged multiple millions in deferred maintenance issues. Continued increases in fees may be possible but this also comes with the risk of lower attendance numbers and reduced public access to state parks. This makes the prospect of partnering with other entities for revenue generation or simply taking over parks a costly endeavor for the entity taking over.

The administration proposed closure of 70 state parks in part or in full. The likelihood of all of those parks closing is slim given the efforts outside entities to take over certain parks. The Legislature should consider the following in the budget year:

- Are funds at the department being spent on the highest priority areas?
- What parks remain on the closure list and is there anything the Legislature can do to provide tools to the department to continue to reduce this list?
- Are there other ways to fund the department or to allocate funding within priority areas of the department?
- Are there parks that should close regardless of a funding sponsor in order to limit state liability and future costs?
- What is the department doing to increase revenues at state parks—and why is it that the National Park System and local nonprofits are able to increase fees to save parks when our state park system is unable to do so?
- Why can’t we introduce entry fees rather than parking fees at all state parks?
- Is it time to change the way we budget for the parks system in general to allow for innovation locally while maintaining a robust statewide system?

Transportation Finance

BACKGROUND:

Transportation finance in California has seen many changes over the past five years as both the federal government and state have modified financing and programs to respond to the economic downturn and budget shortfalls. For transportation, the news has not been all negative – the federal American Recovery and Reinvestment Act (ARRA) provided significant one-time money to the state for economic stimulus. The slow economy has also produced bid savings for transportation projects – with this savings being redirected to fund additional projects. Tight budget times have not escaped transportation finance; however, as loans have been made from transportation special funds to the General Fund to address budget shortfalls, and bond sales have been delayed. This section provides a summary of the various sources of transportation funding and indicates the extent to which one-time funding has been expended, and what loans are still outstanding. The funding described in this section supports state highways, local roads, mass transit, and vehicle safety and regulation. High-speed rail funding is excluded from this section and is covered in another section of this overview.

Overview of Transportation Funding for California

Transportation in California is funded from multiple sources at the federal, state, and local level. Among State departments receiving this revenue are the Department of Transportation (Caltrans), the California Highway Patrol (CHP), and the Department of Motor Vehicles (DMV).

Major Sources of Transportation Funding (in billions)

Funding Source	Annual Amount	Comment
Local revenues	$11.0	About $11 billion annually from locally-imposed revenues such as add-on sales tax, property tax, developer fees, and transit fares. Some reimburses Caltrans for locally-supported work on the highway system.
Federal revenues	4.0	Primarily from the federal gas tax of 18.4 cents per gallon. Allocated to both the State and local governments.
State gasoline & diesel excise tax	5.5	Allocated to the State and local governments from the 35.7 cent state gasoline excise tax and 13 cent diesel excise tax.
Fees on cars and drivers	2.9	Primarily from vehicle registration and driver licenses. Supports the operations of the DMV, CHP and Air Resources Board.
Truck weight fees	0.9	Revenue primarily supports debt service and interest on transportation-related general obligation bonds.
Diesel sales tax	0.6	Primarily supports local transit operators.
GO bonds	3.0	State general obligation bonds, primarily Proposition 1B.
Total	**$28.0**	

Transportation Funding Need in California

The numbers in the prior table are from publications of the Legislative Analyst and Department of Finance, but they also are consistent with a recent publication of the California Transportation Commission (CTC). The CTC published a report in October 2011 entitled, *Statewide Transportation System Needs Assessment*. The CTC report excludes revenues from fees on cars and drivers, and reflects the one-time nature of general obligation bonds, but overall forecasts annual transportation revenues averaging $24 billion over the next decade. The CTC's analysis indicates the cumulative amount of $243 billion over the next decade is less than half of the $536 billion needed to appropriately maintain and invest in the transportation system. Note, the CTC's numbers do not include funding for high-speed rail.

Transportation Fuel Swap

Legislation enacted in 2010 and 2011 modified the tax rates on various transportation fuels to provide more flexibility in the expenditure of those funds. Overall, the changes are revenue neutral and an annual rate adjustment mechanism is included in statute to ensure the revenue neutrality is maintained over time. The fuel swap was originally enacted in 2010, but was reenacted in 2011 to conform to new constitutional requirements added by Proposition 22 and Proposition 26 on the November 2010 ballot. The 2011 legislation was AB 105, and was approved on the Senate floor with a vote of 39 – 0. The fuel swap legislation had the following effects.

- New tax rates: The intent of the legislation was to maintain the current-law amount of revenue, and neither increase or decrease taxes paid. Since the sales tax is applied to a price and the excise taxes are applied to quantity, or gallons, an annual adjustment is made by the Board of Equalization to the excise tax rates to maintain revenue neutrality over time. The fuel tax swap included four main tax adjustments, and the excise rates reflected are the initial base rates, subject to annual adjustment. The changes were as follows:
    - Exempted gasoline from the State's then 6.0 percent sales tax on July 1, 2010.
    - Increased the excise tax on gasoline by 17.3 cents per gallon, to a total of 35.3 cents per gallon, on July 1, 2010.
    - Increased the sales tax applied to diesel fuel by 1.87 percent on July 1, 2011.
    - Decreased the excise tax on diesel by 5.0 cents per gallon, to 13.0 cents per gallon on July 1, 2011.
- General Fund benefit from the fuel swap: General Fund support for transportation increased over the past decade as Proposition 42 of 2002 directed a portion of the State's gasoline sales tax from general purposes to transportation, and the Legislature placed before voters, and they approved major new general obligation bonds for transportation (the $19.9 billion Proposition 1B of 2006, and the $10 billion Proposition 1A of 2008). As the General Fund costs for transportation increased, the state's budget deteriorated and budget cuts were needed. Concurrent with General Fund difficulties, fuel prices increased from the $1.50 to $2.00 range per gallon in the first part of the decade to a $2.50 to $3.50 range per gallon in the latter half of the decade. This price increase brought increased revenues of $1 billion plus to transportation in addition to the new General Fund support of GO bonds and Proposition 42. Given the overall budget situation, the fuel swap sought to use some of the new revenue from $3.00 per-gallon gasoline to fund transportation-related GO bond debt as a General Fund budget solution. Due to constitutional restriction in Proposition 22 of 2010,

truck weight fee revenue of about $900 million per year is directed to GO bond debt instead of fuel excise revenues, but the overall effect is similar for transportation programs and General Fund relief.

The biggest benefit for flexibility was that in decreasing the sales tax on gasoline and increasing the excise tax on gasoline, that revenue could be more broadly used for both highway and transit capitol, instead of just transit operations and transit capital. The flexibility was significant in creating the situation where baseline funding programs could continue while at the same time allowing some of the new revenue to benefit the General Fund through GO bond payment.

- Transportation benefit from the fuel swap: The fuel swap received bipartisan support and was generally supported by transportation interests for the following reasons:
  - The fuel swap maintained the "Proposition 42" level of funding for highways and local roads. This equates to funding in the range of $1.0 billion to $1.1 billion per year.
  - The fuel swap increased funding for transit operators relative to what current law would have provided under Proposition 22 of 2010. The swap was structured to provide base State funding for transit operations of about $350 million per year. However, with higher diesel sales tax revenues, the funding amount in 2012-13 is expected to be closer to $420 million.
  - The fuel swap's direction of about $900 million in truck weight fee revenue to GO bond debt supported the ability of the General Fund to appropriate GO bond proceeds and move forward with the transportation projects funded by Proposition 1B and Proposition 1A.

Repayment of Past Transportation Loans.
Over the past decade, about $5.4 billion in transportation funds have been loaned to the General Fund. Of that amount, about $2.6 billion has been repaid and an additional $218 million is proposed for repayment in 2012-13. Proposition 22 of 2010 amended the constitution to prohibit future loans to the General Fund from the revenue derived from taxes on transportation fuels. This constitutional change will stabilize transportation funding in the future, as multiple loans have occurred over the past decade. Proposition 22 does not prohibit loans to the General Fund from taxes and fees paid on vehicles and the fuel swap enacted last year does direct truck weight fee revenue to some new transportation loans to the General Fund. The weight fee loans are directed to bond debt in future years when bond debt exceeds annual weight fee revenue. Outstanding transportation loans can be placed in three broad categories as indicated in the bullets below and on the table on the following page:

- Loans to be repaid by the General Fund that will support new projects. While there was once about $3.1 billion in loans in this category, loan repayments were accelerated in the relatively-good budget year of 2006-07 and about $800 million remains outstanding. The governor's framework to pay off the "wall of debt" would result in these loans being fully repaid by the end of 2015-16.

- Loans to be repaid by the General Fund that will then fund transportation-related debt service. A total of $932 million is outstanding in this category and will be repaid as needed when eligible bond debt exceeds annual weight fee revenue – this is expected to occur beginning in 2014-15.

- Loans to be repaid from select tribal gaming compacts. Annual revenue of about $100 million will again be directed to this loan repayment beginning in 2016-17 – until then, it is being deposited in the General fund.

Outstanding Transportation Loans (dollars in million)

Transportation Loans to the General Fund (in millions)	Loan Amount	Amount repaid through 2011-12	Repayment in Proposed Budget (2012-13)	Outstanding amount (after 2012-13)	Comment
Group 1: Loans repaid from General Fund to transportation special funds to support new projects					
Propositions 42 loans from 2003-04 and 2004-05	$2,167	$1,832	$83	$252	Constitutionally due $83 million per year.
State Highway Account from 2008-09 and 2009-10	335	200	135	0	Statutorily due by 2013
Highway User Tax Acct from 2010-11	328	0	0	328	Statutorily due by 2021
Vehicle Registration Fees from 2010-11	180	0	0	180	No statutory due date
Various funds from 2008-09	60	23	0	37	Statutorily due by 2013 & 2021
Total	**$3,070**	**$2,055**	**$218**	**$797**	
Group 2: Loans repaid from General Fund and directed to bond debt service (weight fee revenue)					
Weight Fee loans from 2010-11 and 2011-12	$932	$0	$0	$932	Statutorily due by 2021
Total	**$932**	**$0**	**$0**	**$932**	
Group 3: Loans repaid from tribal gaming funds for various uses					
Traffic Congestion Relief Fund loans (from 2001-02 & 2002-03) related to Weight fees	$102	$0	$0	$102	For bond costs. Statutorily repaid in 2016-17 and 2017-18
Traffic Congestion Relief Fund loans (from 2001-02 & 2002-03)	$1,281	$534	$0	$747	For new projects. Statutorily repaid in 2017-18 and after.
Total	**$1,383**	**$534**	**$0**	**$849**	
GRAND TOTAL	**$5,385**	**$2,589**	**$218**	**$2,578**	

Federal ARRA funds.
The federal American Recovery and Reinvestment Act (ARRA) provided highway and road funding for California of $2.6 billion. Legislation in 2009 (AB x3 20, Bass), appropriated and allocated these funds with $1.6 billion directed to regional and local transportation agencies and $1.0 billion directed to Caltrans. Federal funds are received on a reimbursement basis. According to Caltrans, all the ARRA funds have been awarded to projects, and approximately $2.0 billion of the $2.6 billion has been expended and reimbursed from federal funds. While not all ARRA reimbursements have been received, the 2012-13 budget does not include any ARRA expenditures as those funds were fully allocated to projects in prior budgets.

Proposition 1B Bonds.
Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Prop 1B): Prop 1B provides for a general obligation bond issue not to exceed $19.925 billion. The 2012-13 budget reflects $3.0 billion in Prop 1B expenditures for Caltrans, the Air Resources Board, and the Emergency Management Agency, but the Governor's Budget Summary indicates that number may be increased with a revised budget request this spring. The table below summarizes Prop 1B funds by program. "Allocated" means awarded to a project and cleared to begin expenditures and "Liquidated" means bond cash expended from state accounts.

Proposition 1B Bonds (dollars in millions)

Proposition 1B Category	Total 1B Amount	Total Allocated	Total Liquidated	Budget
Corridor Mobility Improvement Account (CMIA)	$4,500	$2,855	$1,009	Caltrans
Transit	3,600	1,349	1,146	State Trans Assistance
State Transportation Improvement Program (STIP)	2,000	1,584	1,199	Caltrans
Local Streets & Roads	2,000	1,961	1,961	Shared Revenues
Trade Infrastructure	2,000	817	46	Caltrans
State Highway Operations and Preservation Program (SHOPP)	750	504	325	Caltrans
State/Local Partnership	1,000	435	54	Caltrans
Grade Separations	250	160	38	Caltrans
State Route 99 Improvements	1,000	447	80	Caltrans
School Bus Retrofit	200	196	195	Air Resources Board
Local Bridge Seismic Retrofit	125	38	17	Caltrans
Intercity Rail	400	166	54	Caltrans
Transit Security	1,000	503	289	CalEMA
Trade Infrastructure Air Quality	1,000	447	358	Air Resources Board
Port Security	100	97	37	CalEMA
Total	**$19,925**	**$11,559**	**$6,808**	

GOVERNOR'S PROPOSAL:

This year's Governor's Budget does not include any significant new changes to transportation finance – in a sense, it represents the "new normal" for transportation funding. The combination of Proposition 22 from 2010 and last year's modified fuel tax swap legislation has added stability to transportation funding as most transportation funds – with the exception of vehicle fees – are constitutionally restricted, and cannot be loaned to the General Fund or used to repay bond debt. The other reality is that one-time funds are being expended, and for this reason funding for transportation may shrink instead of grow over the next five years.

Transportation Revenue: The revenue available for transportation purposes in 2012-13 is similar to that available in 2011-12. These revenues support about $15.3 billion in transportation expenditures in the proposed 2012-13 budget. The only new transportation revenue proposal from the Governor is to reduce vehicle registration fees by $5 for vehicle owners that pay by mail or the internet. This proposal would reduce ongoing transportation revenues by about $100 million annually according to the Administration.

Transportation Loans: The Governor proposes to repay $218 million in outstanding transportation loans from the General Fund to transportation special funds in 2012-13. Repayment of $83 million is constitutionally required and related to "Proposition 42" loans in 2003-04 and 2004-05. Repayment of $135 million is statutorily required, and while the repayment could be deferred, the Administration indicates repayment is necessary to maintain the solvency of the State Highway Account. Finally, the Administration proposes to again set aside truck weight fee revenue not needed for debt service as a loan to the General Fund – as was done with the 2011-12 budget. This weight fee revenue of $350 million would be repaid in future years when needed to pay transportation-related bond debt service.

Proposition 1B Bonds: The budget reflects a placeholder funding level for Proposition 1B expenditures in 2012-13, with the final budget request to follow later this spring. Across budget areas, the total Prop 1B expenditures for 2012-13 are currently reflected at about $3 billion.

ISSUES TO CONSIDER:

Transportation Funding in the "Fuel Tax Swap" World.
The proposed budget continues the benefits for various transportation areas that were part of the fuel tax swap. The tax swap is expected to provide about $700 million in excise tax revenue to each of state highways and local roads, which more than offsets for the revenue lost from Proposition 42 sales tax revenues. Transit agencies are expected to receive $420 million from the diesel sales tax, which exceeds the $350 million originally estimated at the time the fuel tax swap was enacted. The issue for the Legislature to consider is a proposed General Fund solution of $350 million by adopting statutory change that would repeat the 2011-12 budget action of loaning some truck weight fees to the General Fund. Under current law, $635 million of truck weight fees is already directed to 2012-13 bond debt, and this proposal would set aside the

remaining $350 million in 2011-12 and 2012-13 weight fee revenue as a reserve in the General Fund for future bond debt.

Transportation Loans.
As indicated in the background section, the Governor's budget proposes General Fund repayment of $218 million in transportation loans in 2012-13, with $83 million of that amount required by the Constitution. The Governor proposes to delay loan repayment in other areas of the budget totaling $630 million in General Fund budget solution – these loans were previously planned for repayment in 2012-13. The Legislature should consider the Governor's transportation loan repayment proposals in the context of other special fund loans and in the context of the overall budget. The Legislature can consider options to either accelerate or defer transportation loan repayment. Caltrans and the Department of Finance should report at budget hearings on the status of fund balances and the expenditures that would be supported with loan repayment.

One-Time Transportation Funding / Proposition 1B Bond Funds.
Federal ARRA funds for transportation are fully allocated to projects and the majority of project expenditures have occurred and reimbursement has been received from the federal government. The majority of Prop 1B bond funds have been allocated to projects, but some projects have not yet started construction and only about $6.8 billion of the $19.9 billion in bond proceeds have been expended. The Department of Finance indicates that as of December 2011, Caltrans had about $2 billion in bond cash – this amount is higher than the Administration targeted last year. The Administration should report at budget hearings on the status of Proposition 1B projects and bond proceeds, and what it has done to accelerate projects and job creation. The Administration should also report on bond expenditures going forward, planned bond sales in 2012, and how bond cash is being managed to minimize General Fund costs.

Fee Reduction for Vehicle Registration.
The Governor proposes to reduce annual vehicle registration fees by $5 for individuals that pay by mail or on the internet. This would reduce the base fee from $69 to $64. The fee reduction is estimated to reduce visits to Department of Motor Vehicle (DMV) offices and to result in efficiencies totaling about $700,000 and the elimination of 25 positions. The resulting revenue loss would be $75 million in 2012-13 and $100 million in 2013-14 and ongoing. In reviewing this proposal, the Legislature should consider the long-term solvency of the Motor Vehicle Account and the performance standard and service delivery at the DMV and California Highway Patrol – both of which are supported by this revenue. It should also be noted that vehicle registration revenue is eligible for expenditures on infrastructure purposes such as highway maintenance. The Administration should report at budget hearings on its analysis of unmet transportation funding needs and alternatively the benefits from a $5 fee decrease for select motorists.

High-Speed Rail

BACKGROUND:

History: The California High-Speed Rail Authority (HSRA or Authority) was created by Chapter 796, Statutes of 1996, to direct development and implementation of inter-city high-speed rail service that is fully coordinated with other public transportation services. In its first twelve years of existence, the Authority was a small entity with a staff of under 10 and during this period it spent a cumulative amount of about $60 million on program-level environmental studies and other analyses. In 2002, the Legislature enacted, and the Governor signed, AB 1856 (Costa) that would place before voters a bond proposition that would provide $10 billion in bond financing for high-speed rail. Subsequent legislation delayed the bond vote. In 2008, AB 3034 (Galgiani) modified the provisions of the bond act and it was placed before voters as Proposition 1A (Prop 1A) in November 2008. Voters approved Prop 1A, and the project received a further boost in 2009 when the federal American Recovery and Reinvestment Act (ARRA) allocated $8 billion nationally for high-speed and intercity rail. In the last five years, the staff of the Authority and its budget have grown as the Authority has worked to complete the project-level environmental documents and complete initial design work. From its creation, through 2011-12, the HSRA will have spent about $630 million from the following funding sources: Proposition 1A bond funds (about $400 million); federal funds (about $140 million); and various state special funds and bond funds (about $90 million).

High-Speed Rail - the Organization: The Authority is governed by a nine-member Board with five members appointed by the Governor, two members appointed by the Senate Committee on Rules, and two members appointed by the Speaker of the Assembly. Appointments are not subject to Senate confirmation. Members serve four-year terms and receive limited compensation – only $100 per day for performing Authority business, not to exceed $500 in a calendar month. The Board appoints an Executive Director who serves at the pleasure of the Board. The Executive Director and six other executive positions are defined in statute and exempt from civil service – these seven positions may be paid high salaries as determined necessary by the Board and the Department of Personnel Administration to attract persons of superior qualifications. The Authority has a total of 54 authorized staff positions, but has struggled to fill positions and about half of the positions are vacant. Among currently vacant positions are key positions such as the Risk Manager and the Chief Financial Officer. The authority contracts out most of its workload, and has approximately 600 contractors (full-time equivalents) working on the project. The engineering workload is performed by regional contractors, who are managed by both state staff and a statewide program management contractor. In addition to state staff, another contractor performs oversight of the program management contractor. Other contractors and subcontractors have been hired for specialty contracts such as communications and ridership forecasting.

The High-Speed Rail Project Route: The route for the high-speed rail project is generally described in statute and was included in Prop 1A. Phase I of the system would connect the San Francisco Transbay Terminal, through the Central Valley, to Los Angeles Union Station and Anaheim. Phase II of the project would include the corridors of Sacramento–Stockton–Fresno and San Diego–Riverside–Los Angeles. Specific alignments between the listed cities are the subject of the project-level environment process, which is in various stages of completion for different corridors.

The High-Speed Rail Project Cost: The cost to build "Phase I" (from San Francisco to Anaheim) was most recently estimated in the Draft 2012 Business Plan to cost $98 billion, with a higher-cost scenario of $118 billion if more environmental mitigation and infrastructure is required. Earlier studies, carried lower cost estimates. The 2010 Business Plan estimated the Phase I cost at $43 billion (like the Draft 2012 Business plan, in year-of-expenditure dollars). The 2008 Business Plan estimated the Phase I cost at $33 billion in 2008 dollars. None of the recent Business Plans have included cost estimates for Phase II segments.

Proposition 1A of 2008: As indicated above, the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Prop 1A) was approved by voters in 2008 and authorizes $9.950 billion in general obligation bonds for the project. Bonds must be appropriated by the Legislature for expenditure and the bond act lays out other requirements for reporting and expenditure of bond funds.

- <u>Connectivity Funds</u>: Of total Prop 1A bond funds, $950 million is set aside for capital improvements to intercity, urban, and commuter rail that provide direct connectivity to high-speed rail, or are part of the high-speed rail system or that provide capacity enhancements or safety improvements. Of this, $190 million is specifically directed to intercity rail administered by Caltrans. The remaining $760 million is allocated to urban and commuter rail by a formula based on rail miles, vehicle miles, and ridership. The California Transportation Commission (CTC) has approved a program of projects to receive the $760 million; however, both the current and prior administrations have been critical of the CTC's allocation plan. Governor Brown has indicated the projects "appear unrelated to the high-speed rail project or an integrated rail plan." Governor Schwarzenegger and Governor Brown have only approved Prop 1A connectivity funds for positive train control, which is a safety control system, and have vetoed funds appropriated by the Legislature for the other connectivity projects programmed by the CTC. The amount approved for positive train control is $136 million and it appears in Caltrans' budget.

- <u>High-Speed Rail Funds</u>: Of the total Prop 1A bond funds, $9.0 billion is set aside specifically for the high-speed rail project. Up to $450 million is available for general administration and up to $675 million is available for initial construction activities such as environmental studies and preliminary engineering – no match is required for this $1.1 billion. The remaining $8 billion is available for construction; however, a non-bond match of at least 50 percent is required for each corridor or segment. The bond act specifies certain characteristics for the design of the system, including electrified trains capable of sustaining speeds of no less than 200 miles per hour and capacity to achieve travel times between San Francisco and Los Angeles Union Station of 2 hours, 40 minutes.

- Requirements for Construction Expenditures: Prop 1A contains many requirements prior to the use of bond funds for construction expenditures.

    - HSRA report/certification #1: Before requesting an appropriation of bond funds for construction, the HSRA must identify a "usable segment" (a usable segment is defined in the bond act as a portion of a corridor that includes at least two stations) and among other requirements: (1) identify the sources of funds to complete the usable segment; (2) certify the segment can be completed as proposed; (3) certify one or more passenger service providers can begin using the tracks for passenger train service; (4) certify the segment can be used without an operating subsidy; and (5) certify it has completed all necessary project-level environmental clearances necessary to proceed to construction. *The plan was released November 3, 2011.*
    - Legislative appropriation: Bond funds must be appropriated by the Legislature before they can be expended.
    - HSRA report/certification #2. Prior to committing any bond funds for expenditure, the HSRA must submit to the Joint Legislative Budget Committee (JLBC) and Department of Finance (DOF) findings similar to report/certification #1 above, plus a report prepared by a financial services firm that finds the segment can be completed as proposed, would be suitable and ready for high-speed rail operation, and that upon completion, would be usable by a passenger service provider. The DOF shall review the submission and within 60 days, and after receiving any communication from the JLBC, determine if the plan can be successfully implemented.
    - Bond Committee finding: The High-Speed Passenger Train Finance Committee, composed of the Treasurer, the Director of Finance, the Controller, the Secretary of Business, Transportation and Housing, and the chairperson of the Authority, must determine if it is necessary or desirable to issue bonds to carry out the purpose of the bond act, before bonds are sold.

Since the bond act is approved by voters, the Legislature must follow the scheme and design of the bond measure, meaning the Legislature cannot redirect high-speed rail bonds to build highways or school facilities. Other statutory changes to the program may be permitted it they further the purpose of constructing a high-speed trail system in California.

Federal Funding Awards: Federal funds have been awarded from 2009 American Recovery and Reinvestment Act (ARRA) funds and from Federal Fiscal Year 2010 Funds (FFY 2010). In addition to the original grant awards to California, the state has also received funds returned from other states and redistributed. In applying for competitive federal grants, California proposed differing levels of state matching furds. Early grant applications proposed state fund matches of 50 percent (i.e., the state funds 50 percent and the federal government funds 50 percent of project costs), and later grant applications proposed state fund matches of 20 percent. The weighted-average match for all grants is 43 percent state funding and 57 percent federal funding. The federal government awarded the grants contingent on the State fulfilling those match requirements. Included in the ARRA grant to California was $400 million received for the Transbay Terminal in San Francisco. The Transbay Terminal is the northern terminus of Phase I of the HSRA project, but that grant was directly awarded and not included in the state budget for the Authority.

Summary of Federal Grants for High-Speed Rail
(Dollars in Millions)

Federal Award	Date of Award	California HSRA	SF Transbay Terminal	Required State Match (weighted ave.)
ARRA	January 2010	$1,850	$400	50%
FFY 2010	October 2010	715	0	30%
Redistributed ARRA	December 2010	616	0	50%
Redistributed ARRA	May 2011	86	0	20%
Redistributed FFY 2010	May 2011	214	0	20%
Total ARRA		**$2,552**	**$400**	49%
Total FFY 2010		**$929**	**0**	28%
GRAND TOTAL		**$3,480**	**$400**	43%

Federal Deadlines: The ARRA legislation (Public Law 111-5, February 17, 2009) specifies that funds remain "available" through September 30, 2012, and projects must comply with the requirements of subchapter IV of chapter 31 of title 40, that requires full expenditure by the fifth fiscal year after the period of availability – so funds must be fully expended and reimbursed by September 30, 2017. Through grant agreements with the Federal Railroad Administration (FRA), all ARRA funds awarded to California have been obligated, and therefore, have already fully met the September 30, 2012, deadline. The FFY 2010 funds have a deadline of December 2018 for expenditure and reimbursement. The agreements with the FRA specify other "milestones" for the project, for example the milestone for the design-build contractor request-for-proposal (RFP) is December 2011, and the milestone for award of the design-build contract is August 2012. In signing the grant agreement, the HSRA has agreed to meet all the specified milestones, although generally the federal government continues to work with its project partners and amends cooperative agreements as needed for scheduling adjustments.

Federal Funding Restrictions: The federal grant agreement directs funding to construction in the "Initial Central Valley Section" with the exception of about $195 million which is available for preliminary engineering and design on all Phase I segments. Questions have been raised about the ability to move federal funds to other segments of the project, and the federal response is currently "no." A letter dated January 2, 2012, from Deputy Secretary of Transportation John D. Porcari, states the federal government's position that since "no other project could satisfy the statutory deadline, the Federal Railroad Administration cannot re-allocate the Recovery Act and fiscal Year 2010 funds committed to the Central Valley Project to other projects in California."

The Draft 2012 Business Plan and the Funding Plan: The HSRA released its Draft 2012 Business Plan (Draft Plan) on November 1, 2011, and released its Funding Plan on November 3, 2011. The Plans included the new Phase I cost estimates of $98 billion, and also described the phased and blended construction approach which has the following components:

- Step 1 – Initial Construction Segment: Start construction in the Central Valley on a 130 mile segment running from north of Fresno to just north of Bakersfield. This segment would include two station locations of Fresno and a Kings/Tulare regional station. The Draft Plan calls this the "Initial Construction Segment (ICS)" a term which is not used in Prop 1A. This segment has available funding of $6 billion ($3.3 billion federal and $2.7 billion Prop 1A bonds). The Draft Plan indicates this segment would not initially be used for high-speed rail operations, but could be used to improve existing Amtrak service pending completion of further segments for high-speed rail.
- Step 2 – Initial Operating Segment: Complete a segment either south or north of the Central Valley segment that would connect to either San Jose or the San Fernando Valley. The cost of either segment is in the $26 billion range. The funding for this segment would be federal support of $21 billion (either grants of a tax-exempt bond program) and $5 billion Prop 1A bonds. When completed and combined with the Central Valley segment, the HSRA believes the systems would be ready to attract a high-speed rail operator who would be able to establish high-speed rail service and maintain the system without an operating subsidy.
- Step 3 – Bay to Basin Segment: Complete a segment either north or south (depending on the decision in Step 2) that would result in a line running from San Jose to the San Fernando Valley – this is described as the "Bay to Basin" segment, and would cost in the range of $22 billion. The Draft Plan indicates funding would come primarily from federal funds with a local or other match, some operating profits from the completed segment, and in one scenario some private capital investment.
- Step 4 – Phase I Blended: Implement blended operations with existing commuter rail operators and reduced infrastructure investment to connect to the Phase I endpoints of San Francisco and Anaheim. This would cost $24 billion with funding primarily federal with a local or other match.
- Step 5 – Phase I Completed: Fully build-out the Phase I segment with more infrastructure investment on the bookend segments of San Francisco to San Jose and San Fernando Valley to Anaheim. This would cost $20 billion with funding primarily federal with a local or other match.

The updated schedule in the Draft Plan indicates completion of the Initial Construction Segment in the Central Valley in 2018, with completion of the Initial Operating Segment and implementation of high-speed rail service in 2022. Bay to Basin service would begin in 2027, with full Phase I build out in 2034.

Peer Review of the Funding Plan: State law establishes a Peer Review Group to, among other duties, review the Financing Plan and prepare its independent judgment as to the feasibility and reasonableness of the plans, appropriateness of assumptions, analyses, and estimates, and any other observations or evaluations it deems necessary. The Peer Review Group provided its report on the Funding Plan in a January 3, 2012, letter to the Legislature. The report discusses a number of ways the Draft 2012 Business Plan and Funding Plan can be improved and concludes *pending review of the Final 2012 Business Plan and absent a clearer picture of where future funding is going to come from, the Peer Review Group cannot at this time recommend the Legislature approve the appropriation of bond proceeds for this project*. Below are some of the key observations made in the Peer Review Group report:

- The phased and blended approach to construction is a good approach, but the decision should be made now whether the first Initial Operating Segment should be to the north and San Jose or to the south and the San Fernando Valley.
- The completion of the Central Valley Segment by itself may provide little independent utility if the Initial Operating Segment is not completed. Investments on the end segments (San Francisco to San Jose and Los Angeles to Anaheim) would have greater independent utility and benefit from the management experience of CalTrain and Metrolink.
- Completion of the initial operating high-speed rail segment (either San Jose to Bakersfield or Merced to the San Fernando Valley) requires an additional $24 billion to $30 billion beyond the initial $6 billion currently in hand, and the assumption that the federal government will provide these billions of additional dollars in the future is risky. The reports states: *The fact that the Funding Plan fails to identify any long term funding commitments is a fundamental flaw in the program…. The legislature could, of course, rectify this by enacting a dedicated fuel tax or some other form of added user charge that would not aggravate the existing State budget deficit. Lacking this, the project as it is currently planned is not financially "feasible."*
- The HSRA continues to suffer from lack of staff in numbers and experience and this deficiency creates risks that the HSRA can complete the Central Valley segment as scheduled.
- The business model lacks specificity on the role of a private operator and fiscal structure of a concession agreement. Additionally, a private operator should be brought in during the design-build process.
- The ridership forecast would benefit from external and public review and the revenue estimate would improve if a risk-based cost-loaded construction schedule were included.

Current Activity:

The HSRA continues project-level environmental work and initial design work on all segments. The Authority is also engaged in preliminary right-of-way work on the Central Valley Segment. The HSRA has begun the procurement process for future selection of design-build contractors – no contract award is expected until early 2012-13. The Draft 2012 Business Plan is being revised to incorporate some of the input received, and a Final 2012 Business Plan is expected in late February or early March. If funding is approved by the Legislature, the Authority indicates it would be able in 2012-13 to proceed to purchase right-of-way for the project and proceed to construction.

GOVERNOR'S PROPOSAL:

The Governor presents only a placeholder budget for HSRA at this time. The January budget includes $15.9 million for state operations and no funding for capital outlay. The budget indicates no funding was included for capital outlay because the Department of Finance is still reviewing the Authority's Funding Plan and the 90-day review period was not concluded as the budget was finalized. The $15.9 million is primarily funded from Prop 1A bond funds and would provide $11.6 million for staff and administration and $4.3 million for external administration-related contracts. It is anticipated that the Administration will submit a budget request for capital funding after release of the Final Business Plan.

ISSUES TO CONSIDER:

Coming Soon – the Final 2012 Business Plan: By design, draft plans are released to solicit input which can be considered and included in final plans, and signs are the HSRA is adopting this approach. The Final 2012 Business Plan will hopefully respond to some of the issues raised by the Peer Review Group and others. However, it seems unlikely the Authority will be able to address all concerns. One of the biggest issues is federal funding, and it is seems unlikely the federal government will, in the short term, establish an ongoing funding stream for high-speed rail. Absent federal funds, additional state funding could be considered, but that would likely have to come from new revenues instead of more bonds. In a television interview, the Governor mentioned that "Cap and Trade" revenues associated with AB 32 implementation might be a funding source. After its release, the Final 2012 Business Plan will be the primary document for evaluation of the 2012-13 capital funding request.

Alternatives and Options: Since the Authority is unlikely to produce a final plan that includes funding commitments from the federal government beyond the funds already secured, the Legislature will likely have to take action in an environment of risk and uncertainty for the program. Given these risks, the following are some approaches to consider:

- Proceed with the Central Valley segment: The benefits here are federal support for this segment, environmental documents closer to final approval than with other segments, and some limited independent utility for Amtrak. Additionally, this investment would produce a 130 mile segment capable of running high-speed rail trains. The risks are that if no further investment is made to establish a track of sufficient length to support non-subsidized high-speed service, the benefit-to-cost ratio for this investment is lower than what might be achievable with other rail investments in the state. To mitigate this risk, the state could either try to expand the independent utility of this Central Valley investment, or identify other state funds to complete at least an initial operable segment.
- Proceed to improve the Phase I rail corridors without completing a high-speed rail segment: The benefits here are much greater independent utility for the investments made if no additional funds are identified to complete the high-speed rail system. Investments could include the electrification of CalTrain and Metrolink and perhaps some new grade separations or passing tracks. A traditional rail connector from Bakersfield to Palmdale could be explored with a possibility of a later upgrade for high-speed rail. The risk with these approaches is possible loss of federal funds, and the need to find other matching funds for Prop 1A bonds. In some cases, local funds may be available to match state bond funds. While this approach reduces risk, it would not produce a high-speed rail segment and therefore likely delay completion of an initial operating high-speed rail segment - assuming funds are later found to complete such a segment.
- Delay or Suspend the Project: The benefit here is that bond funds are not expended and the state's future debt-service is reduced. It is possible actions of the federal government in the future could provide funding certainty and therefore allow the Legislature to consider

resuming the project in an environment of less risk. Federal funding of $3.3 billion would be at risk in the case of a delay and presumably lost with an indefinite suspension. Should the state decide to resume at a later time, it would likely incur higher costs due to inflation and due to a recovered economy with a less favorable bond and construction market.

The options above are not necessarily mutually exclusive – some Prop 1A bonds funds (connectivity funds, or base high-speed rail funds) could be directed to other segments of the system while still beginning construction in the Central Valley. A short delay could provide additional time for alternatives to be further developed, and may not result in the loss of federal funds.

Budget Hearings: High-speed rail implemented in other countries does appear to provide unique benefits as part of a multi-modal integrated system of transportation. But even if an ongoing funding stream was identified for California high-speed rail, this would still remain a high-risk, high-cost project for other reasons. Budget hearings later this spring will provide a forum to examine the Final 2012 Business Plan and receive public testimony on this project.

SUBCOMMITTEE NO. 3

HEALTH and HUMAN SERVICES

Health

Human Services

Medi-Cal Managed Care

BACKGROUND:

The Medi-Cal program provides health care services to about 7.7 million low-income Californians, including children, seniors, and people with disabilities. The Medi-Cal 2011-12 budget includes total expenditures of $50.2 billion ($15.3 billion General Fund). Generally, each dollar spent on health care for a Medi-Cal enrollee is matched with one dollar from the federal government.

Medi-Cal Delivery and Payment Systems. Medi-Cal uses a variety of service delivery and payments systems. Originally, the primary payment mechanism was fee-for-service (FFS). Under FFS, a Medi-Cal enrollee obtains services from an approved Medi-Cal provider who is willing to take him/her as a patient for the service and accepts the Medi-Cal payment rate set by the state. In contrast, under Medi-Cal managed care, the Medi-Cal enrollee receives a defined package of benefits through a managed care plan. The plan is paid a per member capitated rate for each enrollee. Medi-Cal managed care currently covers approximately 4.3 million Medi-Cal beneficiaries in 30 counties.

Medi-Cal managed care is delivered through three models for its full-scope of services. These are:

- **County Organized Health System.** A County Organized Health System (COHS) is a local agency created by a county board of supervisors to contract with the Medi-Cal program. There are 14 counties in the COHS model. (COHS counties are: Marin, Mendocino, Merced, Monterey, Napa, Orange, San Luis Obispo, Santa Barbara, Santa Cruz, San Mateo, Solano, Sonoma, Ventura, and Yolo.)
- **Two-Plan Model.** Under the Two-Plan model, each designated county has two managed care plans, a local initiative and a commercial plan. (Two-Plan counties are: Alameda, Contra Costa, Fresno, Kern, Kings, Los Angeles, Madera, Riverside, San Bernardino, San Francisco, San Joaquin, Santa Clara, Stanislaus, and Tulare.)
- **Geographic Managed Care.** There are two Geographic Managed Care (GMC) counties in the state. In both counties (Sacramento and San Diego), the Department of Health Care Services (DHCS) contracts with several commercial plans to provide choices to the beneficiaries.

Mandatory Enrollment of Seniors and Persons with Disabilities into Managed Care. In November 2010, California received federal approval for a Section 1115(b) Medicaid waiver from Centers for Medicare and Medicaid Services (CMS) authorizing (among other provisions) expansion of mandatory enrollment of seniors and persons with disabilities (SPDs) into Medi-Cal managed care. This mandatory enrollment began on June 1, 2011 and will last twelve months. Approximately 20,000 people per month are being enrolled. Prior to this, enrollment into managed care was mandatory for children and families in the 30 counties with managed care and SPDs in the 14 COHS counties.

GOVERNOR'S PROPOSAL:

The 2012-13 Medi-Cal budget includes total expenditures of $57.7 billion ($14.8 billion General Fund). It also includes multiple proposals to expand Medi-Cal managed care and to contain costs for this delivery system.

General Fund Savings (dollars in thousands)

Proposal	2012-13
Medi-Cal Managed Care Expansions	
Managed Care Expansion to Dual Eligibles and Long-Term Care Integration	-$621,793
Healthy Families Program Transition to Medi-Cal Managed Care	-$64,377
Federally Qualified Health Center Payment Reform	-$26,046
Managed Care Expansion into Rural Counties	-$2,680
Eliminate the Sunset Date for the Gross Premium Tax	-$161,843
Medi-Cal Managed Care Cost Containment	
Value Based Purchasing	-$75,000
Align Managed Care Policies	-$56,984
Annual Open Enrollment	-$3,568
Managed Care Default Assignment	-$2,409

The administration notes that many of these proposals generate savings immediately; however, since the Department of Health Care Services (DHCS) is budgeted on a cash basis, the incorporation of wrap-around payments for these proposals into the managed care capitation rates will result in an initial first year cost to DHCS, with savings achieved in each subsequent year. To address this cost, the administration is proposing a one-time deferral of managed care payments to the next fiscal year.

Expansions to Medi-Cal Managed Care Timeline

	July 2012	October 2012	January 2013	June 2013	January 2014	January 2015
Dual Eligibles (Medi-Cal benefits)*			phase in over 12 months			
Dual Eligibles' Medicare Benefits*			phase in three years starting with 10 counties			
Long-Term Care Services*			----------phase in over three years--------------			
Federally Qualified Health Centers and Rural Clinics*	----------→ phase-in period not specified					
Healthy Families Children*		-----phase in over nine months----				
Rural Counties				----------→ phase-in period not specified		

*Beneficiaries in non-managed care counties would begin their transition to managed care beginning in 2014-15.

Enrollment of Dual Eligibles into Medi-Cal Managed Care

Background

About 1.2 million of Medi-Cal beneficiaries are enrolled in both Medicare and Medi-Cal and are referred to as "dual eligibles." Medicare is the primary payer for dual eligibles and covers health services, such as physician and hospital services and short-term skilled nursing. Medi-Cal is the secondary payer and typically covers Medicare cost sharing and services not covered by Medicare, as well as services delivered after Medicare benefits have been exhausted. Most long-term care costs are paid for by Medi-Cal including longer nursing home stays and home and community based services designed to prevent institutionalization.

Dual eligibles tend to be low-income seniors and persons with disabilities with multiple chronic conditions and are among the state's highest-need and highest-cost users of health care services. As of January 2011, 70 percent of the dual eligibles were age 65 or older and 30 percent were between 22-64 years of age.

In 2007, California's spending on dual eligibles was about $7.6 billion, representing 23 percent of total Medi-Cal expenditures. The vast majority (about 85 percent) of these beneficiaries access services through the "fee-for-service" delivery system. It is estimated that about 16 percent (175,000) dual eligibles are in a managed delivery system, such as the Program for All-Inclusive Care for the Elderly (PACE), Two-Plan Model managed care, or COHS. (PACE is a capitated benefit provided primarily to certain Medi-Cal and Medicare beneficiaries that offers a comprehensive service delivery system and integrates Medicare and Medicaid financing. Participants must be at least 55 years old, live in the PACE service area, and be certified as eligible for nursing home care.)

Chapter 714, Statues of 2010 (commonly referred to as SB 208), directs the California Department of Health Care Services (DHCS) to create new models of coordinated care delivery for dual eligibles through four pilot demonstrations. To assist with this process, California received a $1 million planning grant from CMS' Office of the Duals and the federal Center for Medicare and Medicaid Innovation.

Governor's Proposal

The administration is proposing to expand the enrollment of dual eligibles into Medi-Cal managed care (dual eligibles in COHS counties are already in managed care) from the four demonstration pilots described above to statewide. The transition of this population and Medicare benefits into Medi-Cal managed care would be phased-in. Starting January 1, 2013, dual eligibles would be mandatorily enrolled into Medi-Cal managed care and would receive their Medi-Cal benefits via managed care. Also starting January 1, 2013, but only in 10 counties, Medicare benefits for dual eligibles would be provided via managed care. Medicare benefits would be phased-in to managed care throughout the state over three years. Medicare and Medi-Cal funding would be combined into a single payment to a managed care plan with this transaction.

Since federal law prohibits the mandatory enrollment of Medicare beneficiaries into managed care, the administration is proposing a passive enrollment of these individuals whereby, dual eligibles would be enrolled into managed care but given the option to return to fee-for-service for Medicare benefits.

Issues to Consider

Administration Has Foregone Pilot Phase and Opportunity to Learn From Demonstrations. The purpose of SB 208 was to develop dual eligibles pilot demonstrations in order to develop effective health care models that integrate Medicare and Medi-Cal services and to learn from these pilots. Under SB 208, the administration is required to conduct an evaluation to assess outcomes and the experience of dual eligibles in these pilot projects and is required to report to the Legislature after the first full year of pilot operation and every year after. With this proposal, the administration has forgone this pilot stage and the ability to learn from the demonstration projects by proceeding with the *statewide* enrollment of dual eligibles into managed care.

Challenges Identified in Mandatory Enrollment of SPDs into Managed Care. The mandatory enrollment of SPDs into managed care that is still underway has identified challenges with ensuring that beneficiaries receive uninterrupted and coordinated care. For example, policies allowing beneficiaries to remain with their fee-for-service provider because of medical instability for 12 months appear to have been misunderstood and inconsistently applied. Additionally, given that about 60 percent of SPDs are defaulted into a managed care plan, it is likely that more beneficiary and provider outreach and education are necessary to ensure continuity of care.

Consumer Protections and Continuity of Care Assurances Are Critical. The administration's goals of enrolling dual eligibles into managed care include: (1) improving the beneficiary's health care, quality of life, and satisfaction with the health care system by eliminating fragmentation and inefficiencies that result from the incongruities between Medicare and Medi-Cal, (2) developing financial models that drive streamlined and coordinated care through shared savings and the elimination of cost shifting, and (3) promote and measure improvements in health outcomes. While these are important goals, it is critical to ensure that consumer protections and quality measures are in place to ensure that a beneficiary receives uninterrupted quality care especially given that dual eligibles have significant health care needs.

Significant Work Needs to Be Done with Federal Government. Integrating Medicare and Medi-Cal services and financing will require a considerable amount of time and effort. These programs have different policies, standards, and appeals processes. Although representatives from CMS have been involved in the discussions regarding the dual eligibles pilots, navigating the differences between these programs will be challenging.

Integration of Home and Community Based and Long-Term Care Services into Medi-Cal Managed Care

Background

Medi-Cal provides long-term care services in both institutional (nursing home) and home and community based settings. In 2011-12, Medi-Cal will spend over $4 billion for nursing home care.

California's home and community based services include:

- **In-Home Supportive Services (IHSS) program.** IHSS provides personal care services to about 445,000 individuals who are blind, aged (over 65), or who have disabilities. The 2011-12 IHSS budget includes $5.0 billion total funds ($1.4 billion General Fund). See the IHSS section of this report for a detailed discussion of the Governor's IHSS proposal.
- **Multipurpose Senior Service Program (MSSP).** With a budget of $50.5 million ($25.2 million General Fund), MSSP provides case managed services for frail, elderly clients who wish to remain in their own homes and communities. Clients must be age 65 or older, eligible for Medi-Cal, and certified (or certifiable) as eligible to enter into a nursing home. A team of health and social service professionals assess each client to determine needed services and then work with the clients, their physicians, families, and others to develop an individualized care plan. Services that may be provided with MSSP funds include, but are not limited to: care management, adult social day care, housing assistance, in-home chore and personal care services, respite services, transportation services, protective services, meal services, and special communication assistance. The California Department of Aging (CDA) currently oversees the operations of the MSSP program statewide and contracts with local entities that directly provide MSSP services. The program operates under a federal

Medicaid Home and Community-Based, Long-Term Care Services Waiver and serves approximately 12,000 clients per month.

- **Community-Based Adult Services (CBAS) program.** The CBAS program will replace the Adult Day Health Care (ADHC) program on March 1, 2012. AB 97 (Chapter 3, Statutes of 2011) eliminated ADHC services from the Medi-Cal program effective July 1, 2011. A class action lawsuit sought to challenge the elimination. A settlement of the lawsuit was reached that establishes a new program, CBAS. Approximately 15,000 of the 35,000 people that were formerly eligible for ADHC will be eligible for CBAS. ADHC/CBAS is an organized day program of therapeutic, social and health activities and services provided to elderly persons or other persons with physical or mental impairments. The ADHC/CBAS budget for 2011-12 is $289 million ($144.5 million General Fund).

Medi-Cal managed care health plans bear limited financial risk for beneficiaries who are placed in long-term care institutions, such as nursing homes, and for the most part, do not cover home and community based services. These services are covered under Medi-Cal FFS.

Governor's Proposal

The governor proposes to integrate long-term institutional care and home and community based services into the Medi-Cal managed care benefit. The inclusion of these benefits into managed care would begin January 1, 2013 and be phased in over three years. The administration's goal with incorporating long-term care and HCB programs into managed care is to promote the coordination of health and social care for Medi-Cal beneficiaries and to create fiscal incentives for health plans to make decisions to keep their members healthy and out of institutions (given that hospital and nursing home care is more expensive than HCB care). Since the rates for these health services are set by the state, the administration argues that health plans would be required to pay this rate. Consequently, the administration expects a decrease in institutional care utilization and an increase in HCB services.

Additionally, as part of this proposal, the administration is proposing to develop a standard tool that would be used to assess a beneficiary's need for home and community based programs. (Currently, each of the above mentioned programs has their own assessment tool and questions.) The administration is also proposing a stakeholder process to begin in June 2013 that would be used to gather feedback and perspective to shape the future phasing in of these services.

This proposal and the enrollment of dual eligibles into managed care discussed above, would save $678.8 million General Fund in 2012-13 and $1 billion General Fund in 2013-14. The 2012-13 savings would be due to a payment deferral to Medi-Cal providers (since Medi-Cal is budgeted on a cash basis). The administration estimates the proposal would achieve ongoing savings of $1 billion starting in 2013-14.

Issues to Consider

Integration of Medical and Social Services Valuable Goal. Long-term care has traditionally been dominated by the medical model, in which focus is placed primarily on an individual's disease or condition rather than their overall needs. However, this model fails to take into account the effect an individual's behavioral health and social supports has on their physical health. Some of the most successful long-term care programs are those that integrate medical and social services, and in doing so, improve a person's health status and overall quality of life. Furthermore, most studies have found that managed long-term care programs reduce the use of institutional services and increase the use of home and community based services relative to fee-for-service programs, and that consumer satisfaction is high. However, this integration is a complex endeavor and will require extensive stakeholder engagement.

Potential for Improved Care Coordination But Must Monitor Outcomes. The current fragmented system of programs and services can leave beneficiaries on their own to link their needs with available services. Making a health plan responsible for the delivery of all benefits, health and social, could lead to better care coordination. However, under such a proposal, it would be important for the state to develop measures to evaluate enrollee outcomes to ensure that managed care plans are not cutting long term care services and costs inappropriately. Additionally, it would be important for the capitation payment to be set at the right level to encourage plan behavior that leads to improved health outcomes.

Incorporating IHSS Services and Funding a Major Policy Proposal. This is a major policy proposal that is linked to substantial General Fund savings. While improved health outcomes may be linked to integrating these services, careful review of the trailer bill will be required. Additionally, please see the IHSS section of this report for a discussion on issues to consider regarding the integration of IHSS into Medi-Cal managed care.

Payment Reform for Federally Qualified Health Centers and Rural Health Clinics

Background

Federally Qualified Health Centers (FQHCs) and Rural Health Clinics (RHCs) are community based centers that provide primary and preventative health care services to medically underserved populations or areas without regard to a patient's ability to pay. In addition to receiving grants from the federal government, these health centers are reimbursed for providing Medicare and Medi-Cal services. There are 681 FQHCs and 293 federally designated RHCs in California. In 2009-10, FQHCs and RHCs represented over 90 percent of Medi-Cal expenditures for clinic-based care.

Federal law requires Medi-Cal to reimburse FQHCs and RHCs based on reasonable costs. The current reimbursement system is based on a prospective payment system (PPS). Under PPS, Medi-Cal generally reimburses centers a per-visit rate, which is adjusted by the Medicare Economic Index annually. (FQHCs and RHCs were exempt from the 10 percent provider rate reduction authorized in the 2011-12 budget.)

Medi-Cal managed care plans commonly contract with FQHCs and RHCs as part of their provider networks and are required to reimburse FQHCs and RHCs in their networks for providing services to plan beneficiaries at rates that are, at a minimum, comparable to other providers of similar services in the same network. Federal law requires Medicaid programs to make up the difference between negotiated rates paid by managed care plans and a center's guaranteed PPS fee-for-service rate. An annual reconciliation determines the total difference between plan payments and PPS payments for the number of patient visits. These "wrap-around" payments (or supplemental payments) paid by Medi-Cal to FQHCs and RHCs with managed care contracts totaled $229 million General Fund in 2009-10.

Governor's Proposal
The administration proposes to integrate all FQHC and RHC costs into managed care capitated rates by reforming the payment methodology under Medi-Cal. Under this proposal, payments made to FQHCs and RHCs (participating in Medi-Cal managed care contracts) will change from the PPS system--a cost and volume-based payment--to a fixed payment to provide a broad range of services to its enrollees. The administration argues that this would create a performance, risk-based payment model that rewards clinics for providing more efficient and better care. The "wrap-around" payment funds would also be included in the capitated rate; thereby requiring health plans to be fully responsible for reimbursement to FQHCs and RHCs. (Payments to FQHCs and RHCs for beneficiaries who are both Medicare and Medi-Cal eligible would be exempt from this proposal.)

The administration is seeking a waiver from the federal government to reform the payment methodology and to eliminate current restrictions that prevent best practices, such as group visits, telehealth, preforming multiple services on the same day, and telephonic disease management. It argues that eliminating these operating constraints would create efficiencies and allow FQHCs and RHCs to institute best practices. These efficiencies would result in a ten percent efficiency adjustment; thereby saving $26 million General Fund in 2012-13 and about $58 million in 2013-14. In order to realize the budget year savings, the administration is proposing to delay $43.6 million (General Fund) in managed care payments to FQHCs and RHCs into 2013-14.

Issues to Consider
Rate Cut's Impact on Sustainability of these Centers. Though the elimination of operating restrictions to allow centers to provide care the best way they see fit could allow for system efficiencies and could lead to better quality care; the reduction in payment to these centers may impact access. It is unclear the extent to which centers might achieve operating efficiencies and savings with the removal of certain restrictions. Given that in 2010, 64 percent of primary care visits for Medi-Cal beneficiaries was provided in these centers, it is critical that any type of rate reform not impact the sustainability of these centers.

Major Redesign of Payment and Delivery System. This is a major policy proposal with a very aggressive timeline. This proposal would require federal approval and have a major impact on the clinic delivery system.

Healthy Families Program Transition to Medi-Cal

Background
The Healthy Families Program (HFP) offers low cost insurance that provides health, dental, and vision coverage to children up to age 19 in families with incomes up to 250 percent of the Federal Poverty Level (FPL) who do not have insurance and do not qualify for no-cost Medi-Cal. Families pay a monthly premium and the program subsidizes the remaining cost of coverage.

The HFP has a tiered premium structure that specifies low premiums for families under 150 percent of FPL and higher premiums for higher-income families. The General Fund supports 35 percent of the program and federal Children's Health Insurance Program (CHIP) fund reimburses 65 percent of total program costs. There are currently about 877,000 children in the HFP.

Federal health care reform implements changes to the nation's health care system. Among these changes, it requires states to expand Medi-Cal eligibility for children in families with income up to 133 percent of FPL in 2014. Currently children age 1 to 5 in families with income up to 133 percent of the FPL and children age 6 to 19 in families with income up to 100 percent of the FPL are eligible for Medi-Cal.

Governor's Proposal
The budget proposes to reduce the rates paid to health, dental, and vision plans for the Healthy Families Program (which average $103.44) to the average combined Medi-Cal rate of $76.86. This is projected to result in General Fund savings of over $64 million in 2012-13. (The state would still claim federal reimbursement of 65 percent for these children under this proposal.)

Additionally, the budget transfers the approximately 877,000 children in HFP into Medi-Cal over a nine-month period beginning October 2012. The administration proposes that this transfer would create benefits for children, families, health plans, and providers by simplifying eligibility and coverage for children and families, improving coverage through retroactive benefits, increased access to vaccines, expanded mental health coverage, and eliminating premiums for lower-income beneficiaries. To the extent possible, HFP children enrolled in managed care or dental managed care plans that are also contracted plans under Medi-Cal will remain with the plan; otherwise, they will be afforded the option of choosing from available Medi-Cal managed care or dental plans in their respective county. Children residing in counties without a Medi-Cal managed care plan will receive their Medi-Cal under the FFS delivery system until managed care is available.

Healthy Families Program Transition to Medi-Cal Timeline

Transition Period	**Impacted Beneficiaries**	**Number Impacted**
Phase 1 October – December 2012	HFP children enrolled in a managed care plan that directly contracts with Medi-Cal	410,666
Phase 2 January – March 2013	HFP children enrolled in a managed care plan that subcontracts with Medi-Cal	424,103
Phase 3 January 1, 2013 →	HFP children in counties without Medi-Cal managed care	43,090

Issues to Consider
Transition Plan Information Not Yet Available. Last year's budget act included language requiring the administration to develop a transition plan for the transfer of administrative functions for the operation of HFP (and the Access for Infants and Mothers Program) to the Department of Health Care Services and submit the plan to the Legislature no later than

December 1, 2011. This plan has not yet been submitted. Additionally, details on the assurance of network adequacy and provider continuity and access; enrollment and eligibility timeframes and standards; notification and outreach efforts; and process for stakeholder consultation are not yet available.

Some HFP Children Will Be Shifted to Medi-Cal Under Federal Health Care Reform. Additionally, as discussed above, under federal health care reform, HFP children with incomes under 133 percent of the federal poverty level (approximately 186,000 children as of November 2011) would become Medi-Cal beneficiaries on January 1, 2014. With this proposal, the administration has decided that children in families with incomes *over* 133 percent of FPL should also move to Medi-Cal even though this is not required by health care reform. As implementation of health care reform moves forward, including the development of the Health Benefit Exchange, the Legislature may want to consider if it would be more appropriate for these children in higher income families to obtain coverage from the same provider as their parents.

Incorporate HFP's Strengths into Medi-Cal. Generally speaking, based on 2009 HEDIS (Healthcare Effectiveness Data and Information Set) quality measures, HFP and Medi-Cal show relatively little difference in quality of care indicators. Furthermore, each program has historically had its own strengths, for example, most would agree that HFP has provided better access to care than Medi-Cal (HFP's higher reimbursement rate is likely a contributing factor to this) and that the Managed Risk Medical Insurance Board has a stronger focus on children's issues, while Medi-Cal's mental health coverage is more broad than HFP and Medi-Cal has more rigorous due process regarding grievances. If these children are shifted to Medi-Cal, the administration should work to ensure that the strengths of the HFP program are incorporated into the Medi-Cal program.

Reduction to HFP Rate Could Impact Access and Continuity of Care. Finally, it is unclear how plans that contract with HFP will behave if their reimbursement rate is reduced by 25 percent, as proposed by the administration, and how this might impact access to care for these children. Additionally, some children in HFP could experience an interruption in care as their provider may choose not to be part of the Medi-Cal managed care network.

Expand Medi-Cal Managed Care into Rural Counties

Governor's Proposal

The budget proposes to expand managed care into the remaining 28 rural counties that are now fee-for-service only beginning in June 2013. The administration proposes that the above described expansions to managed care would support the development of adequate provider networks in rural counties. This would result in $2.7 million General Fund savings in 2012-13 and $8.8 million in 2013-14.

Issues to Consider

Unclear if Provider Network in Rural Counties Would be Adequate. Critical to the expansion of managed care into rural counties is ensuring provider participation in a managed care network. Other states which have made managed care mandatory in rural areas have faced challenges finding providers willing to participate. Similarly, it is unclear if health plans are willing to participate in rural areas. Without participating providers and health plans, expansion of managed care into rural areas may not be feasible.

Eliminate Sunset Date of Gross Premium Tax on Managed Care Plans

Background

The managed care gross premium tax is a tax on the gross revenues of a managed care plan. It is used by the state to draw down federal funds to fund children's health services under the Healthy Families Program and to increase the capitation rates paid to Medi-Cal managed care plans.

Governor's Proposal

The budget proposes to eliminate the sunset date of the Gross Premium Tax on Medi-Cal managed care plans. Continuing the tax, coupled with the proposed increased managed care utilization discussed above, would generate General Fund savings of $161.8 million in 2012-13 and $259.1 million in 2013-14. Since this tax is based on a managed care plan's gross revenue, if any of the proposed expansions to Medi-Cal managed care (discussed above) are not implemented, the General Fund savings would be reduced.

Value Based Purchasing

Background

Currently DHCS must use regulations or statute to add, modify, limit, or eliminate reimbursement and services in the Medi-Cal program. The regulatory process can often take at least a year to complete.

Governor's Proposal

The budget proposes trailer bill language to develop a process to evaluate the cost-effectiveness of services and payment and rate design to ensure that Medi-Cal beneficiaries and the state are receiving value. Generally, under the new process, DHCS would review scientific literature and stakeholder input regarding a particular service, for example, to determine if that service provides little or no value to a beneficiary. If it finds that the service provides minimal value, then it would engage stakeholders to discuss the proposed changes to services. After a review of stakeholder input, which may include stakeholder meetings, DHCS could make changes to benefit design and seek federal approval, if necessary. Additionally, the administration proposes to include a post-implementation assessment to ensure that changes achieve the intended results. Examples of potential program changes include reducing laboratory rates, no longer funding avoidable hospital admissions, and no longer paying for services of limited value.

This proposal would save $75 million General Fund in 2012-13 and annually thereafter. Of the $75 million, $26.6 million in 2012-13 and $30 million in 2013-14 is estimated to be a result of adjusting managed care plan rates for situations when a person acquires a preventable health condition in a health care setting as required by federal health care reform. (CMS will begin enforcing this requirement by July 1, 2012.)

This new process would mostly apply to the FFS system; however, the administration argues that this process may drive changes in managed care as health plans often follow FFS policy.

Issues to Consider

Safeguards to Ensure Stakeholder Participation Unclear. While the administration argues that the Medi-Cal health care delivery system needs to be able to more rapidly respond to the changing field of health care than the current regulatory process allows, the proposed process is outside the current regulatory framework which has established safeguards to ensure stakeholder participation and disclosure of departmental actions. How this process would ensure an appropriate level of input from stakeholders and accountability to the public and Legislature is unclear.

Align Managed Care Policies

Background

Medi-Cal covers the cost of medical services provided to beneficiaries during a retroactive period of 90 days before their enrollment into Medi-Cal. County Organized Health Systems (COHSs) cover the cost of the retroactive period through an adjustment in their capitation rates. The Two-Plan and Geographic Managed Care (GMC) health plans are not responsible to cover the costs of their enrollees during the retroactive period, as these costs are paid via fee-for-service (FFS) (outside of their capitation payment).

Governor's Proposal

The administration proposes to align COHS' responsibility for the retroactive period with the Two-Plan and GMC methodology and pay for these services through FFS. An estimated savings for $57 million General Fund would be achieved in 2012-13 and $7.5 million General Fund annually thereafter.

Institute Annual Enrollment Process for Medi-Cal Managed Care

Background

Current law allows Medi-Cal beneficiaries in a Two-Plan Model and Geographic Managed Care (GMC) model to change health plans once per month or up to 12 times in a year. Mandatory enrollment of SPDs into managed care began June 2011 and will be completed at the end of the current budget year. Managed care is a new approach for hundreds of thousands of individuals many of whom have unpredictable and changing needs that may require them to change plans more than once per year to ensure, for example, that they have access to particular specialty care providers.

Governor's Proposal

The budget proposes trailer bill language to change this existing managed care enrollment policy to only allow Medi-Cal enrollees in Two-Plan and GMC counties to change plans once a year. Essentially, a notification would be mailed to each health plan member to allow the individual the opportunity to change health plans during a specified enrollment period. The administration estimates that instituting an annual enrollment process for Medi-Cal managed care would result in a General Fund savings of $3.6 million in 2012-13 and $6 million in 2013-14. It should be noted that this proposal requires an amendment to California's 1115 Medicaid Waiver, and is a change to SB 208, Statutes of 2010, which provided the framework for the mandatory enrollment of SPDs into Medi-Cal managed care.

Issues to Consider

Mandatory Managed Care Enrollees Need Ability To Change Plans. The administration submitted a similar proposal in last year's May Revision. This proposal was rejected by the Legislature given that SPDs are still in the process of being enrolled into a managed care plan and need transition time to make changes and feel comfortable with their plans. Furthermore, given that about 60 percent of SPDs are being defaulted into a managed care plan, it is important to ensure that these beneficiaries have time to understand the changes to how their health care services will be provided and have the opportunity to change plans in order to meet their health care needs.

Change Default Health Plan Assignment for Medi-Cal Managed Care

Background

When a Medi-Cal beneficiary is enrolled in managed care but does not select a health plan, a default health plan is assigned to the beneficiary. In 2005, DHCS developed default ratios to base this default assignment on health plan quality of care measurements and safety net populations.

Governor's Proposal

The administration seeks to change the default health plan assignment (for families and SPDs) to consider health plan costs in addition to quality of care and safety net population factors. The administration finds that this new assignment methodology would reward plans with lower costs with additional default enrollment. This would result in $2.4 million General Fund savings in 2012-13 and $5.8 million in 2013-14.

Issues to Consider

Does Low Cost Ensure Quality Care? While costs should be a consideration when defaulting a person into a managed care plan, careful consideration must be made to ensure that the low-cost health plans offer quality care and that cost does not become the most important factor in this assignment.

Department of State Hospitals

BACKGROUND:

The Department of Mental Health (DMH) operates five state mental hospitals and two psychiatric programs within state prisons (California Medical Facility and Salinas Valley State Prison), which provide inpatient mental health treatment. Four of the mental health hospitals – Napa, Metropolitan (Norwalk), Atascadero, and Patton (San Bernardino) – were constructed more than 50 years ago. In 2005, DMH opened the Coalinga Mental Hospital to provide treatment for sexually violent predators. DMH also oversees a variety of state and local public mental health programs. In 2011, funding for some local mental health services was realigned to counties.

The majority of the state hospital population, approximately 92 percent, is forensic or penal code related. Major categories of state hospital patients include:

- Judicial commitments directly from superior courts - Not Guilty by Reason of Insanity (NGI) and Incompetent to Stand Trial (IST)
- Civil commitments as Sexually Violent Predators (SVPs)
- Referrals/transfers from California Department of Corrections and Rehabilitation (CDCR) including Mentally Disordered Offenders (MDOs) and Parolees
- Civil commitments from counties under the Laterman-Petris-Short Act

On May 2, 2006, the United States Department of Justice (USDOJ) and the State reached a settlement concerning civil rights violations at four state mental hospitals. The judgment called for Metropolitan State Hospital, Napa State Hospital, Patton State Hospital, and Atascadero State Hospital to implement an "Enhancement Plan" to improve conditions. Coalinga was not covered by the agreement because it had just opened, but it has similar reforms in place now. The extensive reforms required by the five-year Consent Judgment were to ensure that individuals in the hospitals are adequately protected from harm and provided adequate services to support their recovery and mental health.

The USDOJ conducted its investigation pursuant to the Civil Rights of Institutionalized Persons Act of 1980 (CRIPA). This statute allows the federal government to identify and root out systemic irregularities such as those identified in this case, rather than focus on individual civil rights violations.

In November of 2011, the USDOJ released Patton State Hospital and the Atascadero State Hospital from oversight, deeming them in compliance with the bulk of the consent judgment's demands. However, DOJ officials asked a judge to extend federal oversight of Napa State Hospital and Metropolitan State Hospital, saying the facilities have failed to comply with critical provisions of the consent judgment.

In July of 2011, DMH commissioned a report to assist in the proposal for a state mental hospital department to be included in the 2012-13 Governor's Budget. The scope of the project was to recommend the administrative structure for a state mental hospital department, to identify processes that might be organized differently for better performance and accountability, and to collect information on the department's budget deficit. The report was released in December 2011.

GOVERNOR'S PROPOSAL:

The Governor's budget proposes to eliminate DMH, proposes to create the Department of State Hospitals (DSH), and transfer responsibility for community mental health programs to other state departments. The budget includes $1.4 billion from all fund sources and 9,861.3 positions to support 6,439 patients in 2012-13.

(dollars in millions)

Program	Positions	Funding
In-Patient Services Program	9,594.7	$1,411.6
Evaluations and Forensic Services	75.1	$21.4
Legal Services	24.7	$5.6
Administration	166.8	$16.7
Distributed Administration	-	-$16.7
Total	**9861.3**	**$1,438.6**

The budget proposes to transfer the majority of community mental health programs for DMH to the Department of Health Care Services (DHCS). In total, the budget transfers $104.7 million from DMH to other state departments or entities, as follows:

(dollars in millions)

Department	Function/Program	Positions	State Ops.	Local Assist.	Total
Health Care Services (DHCS)	Financial Oversight, Certification Compliance, Quality Improvement, Mental Health Services Act (MHSA) State Functions, County Data Collection and Reporting, Suicide Prevention, Co-Occurring Disorders, Veterans Mental Health, Substance Abuse and Mental Health Services Administration Block Grant, Projects for Assistance in Transition from Homelessness, Training Contracts, CA Institute for Mental Health, CA Health Interview Survey, Policy Management, Admin Staff, CA Mental Health Planning Council	41	$11.1	$61.2	$72.3
Social Services	Licensing/Quality Improvement (Mental	12	$1.1	$-	$1.1

(DSS)	Health Rehabilitation Centers, Psychiatric Health Facilities)				
Mental Health Services Oversight and Accountability Commission	Training Contracts – Consumer Groups, MHSA Program Evaluation	-	$1.7	$-	$1.7
Public Health	Office of Multicultural Services, Disaster Services and Response	4	$2.3	$-	$2.3
Education (CDE)	Early Mental Health Initiative	0	$-	$15.0	$15.0
Office of Statewide Health Planning and Development	Mental Health Services Act Workforce Education and Training	1	$.1	$12.2	$12.3
	Totals	**58**	**$16.3**	**$88.4**	**$104.7**

ISSUES TO CONSIDER:

The department must improve fiscal oversight. DMH hospitals experienced deficits in 2009-10 and 2010-11. As previously mentioned, a thorough evaluation of the state hospital system and its budget was performed in developing the new DSH. The report highlighted unfunded activities within the system, some of which were the result of federal court orders. However, the report also found that the deficit was the result of appropriation reductions that were not operationalized, coupled with expenditure increases, one of which was for an expansion of the court-ordered Enhancement Plan that was not authorized by the Legislature. Further, the report found that the department contributed to the deficiency through a lax approach to fiscal management and broad fiscal oversight deficiencies, including:

- Lack of management support for cost-consciousness and fiscal accountability.
- Lack of detailed base budgets and other fiscal systems necessary for budget control.
- Lack of training for budget control; and rudimentary implementation of the accounting system resulting in the inability to collect necessary cost data.
- An overall system of appropriation control that is deficient.
- Detailed base budgets missing in headquarters and the hospitals.
- No shared culture of cost containment in the department as a whole, much less for patient care.

The report also proposed a plan to address the current year funding shortfall of approximately $180 million. In the budget, through a combination of current year cost saving measures, the shortfall is reduced to approximately $63 million. However, achieving the cost saving measures that are included in the budget and containing costs in general will not be easy without addressing the issues noted above. The department must provide the Legislature with assurance that it has the proper structure, processes, and tools to effectively manage its resources.

Staff and patient safety. Over the past 20 years, the hospital system has moved away from its community origins. The percentage of forensic and penal code patients has increased, bringing an increasing risk of violence, sometimes different treatment objectives, and an aging, more medically fragile patient population. With the exception of Coalinga, DMH hospitals were not built for a forensic population.

Each state hospital has varying specialty treatment programs, security, and staffing patterns. Some differences are:

- Napa and Metropolitan, due to the nature of their campuses, are restricted in how many penal code-related patients may reside at their facilities and only accommodate lower-level/less-security risk individuals.
- Metropolitan does not have a perimeter fence and has limited security.
- Coalinga receives the SVP patients and, generally, the more difficult to serve MDOs.
- Patton has had the highest population for many years and the state has the authority to "over-bed" at this facility per a long-standing licensing agreement.
- Patton has historically had CDCR staff patrol the perimeter fence and provide additional security.

Last February, the subcommittee discussed DMH hospital safety and security issues due to a number of assaults on hospital staff and patients, including a homicide of a staff member at Napa in October of 2010. In addition, the DMH evaluation conducted last year also highlighted safety as a key concern of staff. Although a number of steps to enhance hospital safety have been taken, or are planned, this issue must not be overlooked in the department's restructuring. Initiatives taken or underway to address violence within the state hospitals include:

- In response to the homicide, Napa has been developing and implementing several safety enhancements, including: development of an Enhanced Safety Plan by hospital police, revisions of various policies/procedures and leadership changes, and stakeholder meetings and summits to address violence issues.
- The 2011 budget includes measures to address the increase in violence and aggressive behavior in the state hospitals, including: implementation of Grounds Presence/Safety Teams to monitor secure treatment areas and a pilot project for personal alarms at Napa.
- Current proposals include enhanced resources for the Napa personal alarm system and to roll the alarm system out to other four state hospitals over the next two years; establishment of an Enhanced Treatment Unit at Atascadero, creating flexible patient and staff ratios based on aggression; and developing and implementing new safety and response policies with the California Occupational Safety and Health Administration.

State hospital role in treating CDCR inmate-patients. As DMH's forensic population has increased, so too has their role in treating CDCR inmate-patients. The DMH provides inpatient mental health care services in licensed beds to *Coleman* (lawsuit and court order pertaining to deficiencies of CDCR's Mental Health Program) class inmate-patients referred by the CDCR.

System wide, DMH operates a total of 886 beds for *Coleman* class inmate-patients of which 336 are in state hospital programs and 550 are in psychiatric programs imbedded in two CDCR institutions. In addition, the budget proposes to free up additional beds at Atascadero as part of a plan to reduce the *Coleman* bed waitlist and the department is committed to operate 475 licensed inpatient mental health beds at a new 1,722 bed CDCR facility that is scheduled to activate in December 2013.

As DMH's role in treating inmate-patients increases, it is important to examine the continuum of care for CDCR mental health patients. Questions to consider include:

- How does mental health treatment compare between the two departments (are there comparable outcome measures)?
- What is the process for referring patients from CDCR to state hospital programs?
- As DMH's role within CDCR institutions increase, should their role be expanded further in treatment of inmate-patients?
- Is the state maximizing efficiencies in care and resources (staff classifications, drug purchases, contracts, etc.)?

In-Home Supportive Services (IHSS)

BACKGROUND:

With a 2011-12 budget of $5.0 billion ($1.4 billion GF), the IHSS program provides personal care services to approximately 440,000 qualified low-income individuals who are blind, aged (over 65), or who have disabilities. IHSS services include tasks like feeding, bathing, bowel and bladder care, meal preparation and clean-up, laundry, and paramedical care. These services frequently help program recipients to avoid or delay more expensive and less desirable institutional care settings. The maximum number of monthly hours a beneficiary can receive is 283.

A Few Facts About IHSS:

- There are 440,000 low-income IHSS recipients who are aged, blind, or who have disabilities.
- Services include personal care (bathing, grooming, etc.), as well as domestic and related activities of daily living.
- There are 366,125 IHSS providers whose wages vary from $8.00 to $12.20 hourly.
- In 2012-13, services are estimated to cost an average of $11,420 annually per client.

Funding and Oversight: IHSS is funded with federal, state, and county resources. Recently, the state opted to implement the program under a new federal Medicaid waiver option called the Community First Choice Option (CFCO), which offers an enhanced rate of 56 percent federal financial participation (six percent over the base rate of 50 percent). The state is also benefitting from an additional enhanced rate of 75 percent for a period of one year for IHSS recipients transitioning from nursing facilities to community-based settings. The state and counties split the non-federal share of IHSS funding at 65 and 35 percent, respectively. The average annual cost of services per IHSS client is estimated at $11,420 for 2012-13. The Department of Health Care Services is the statewide agency responsible for administering and supervising the state's Medicaid plan, including federal funding for IHSS. At the same time, the Department of Social Services oversees local administration of the program, which is usually managed by county social services agencies and public authorities.

Program Structure and Employment Model: County social workers determine eligibility for IHSS after conducting a standardized in-home assessment, and periodic reassessments, of an individual's ability to perform specified activities of daily living. Once eligible, the recipient is responsible for hiring, firing, and directing an IHSS provider or providers. The counties or public authorities must conduct a criminal background check and provide an orientation before a provider can receive payment. At the end of 2011, there were just over 366,000 working IHSS providers. County public authorities are designated as "employers of record" for collective bargaining purposes, while the state administers payroll, workers' compensation, and benefits. Hourly wages for IHSS providers vary by county and range from the minimum wage of $8.00 per hour in nine counties to $12.20 in one county. The state participates in the costs of wages up to $12.10 ($11.50 plus $.60 for health benefits) per hour, with counties paying the difference if they negotiate a higher wage. In approximately 72 percent of cases, IHSS recipients choose a family member to provide care (including roughly 45 percent of providers who are a spouse, child, or parent of the recipient). In around half of cases, IHSS providers live with the recipients. Public authorities also maintain registries of approved caregivers for recipients who want assistance finding a provider.

Recent Changes: The last three budgets included significant changes to IHSS. The following are in effect or pending implementation (savings are annual for 2012-13 unless otherwise noted):

Additional **program integrity measures**, including background checks and criminal records exclusions for providers, more training for social workers, changes to time sheets, and directed mailings or unannounced home visits when there is a concern.
Savings of $151.1 million General Fund from a requirement for recipients to obtain from a licensed health professional **a certification of their need** for services to prevent risk of out-of-home care.
Savings of $145.1 million General Fund from the federal **CFCO waiver** option.
Upon federal approval, savings of $95.5 million General Fund as a result of a **sales tax on supportive services** and matching funds for the use of the tax revenues.
Current year savings of $64.4 million General Fund from an **across-the-board reduction** of 3.6 percent in all recipients' authorized hours until July 1, 2012.
Increases in **out-of-pocket costs for consumers** (resulting from elimination of what was called a "share-of-cost buy-out").
Reductions in administrative funding for Public Authorities.

The following changes were also enacted, but federal courts have stopped them from taking effect as a result of ongoing litigation:

Savings of approximately $222.0 million General Fund (full year impact) from an across-the-board reduction, subject to specified exemptions and exceptions, of 20 percent of authorized hours. This reduction was triggered by lower than anticipated 2011-12 revenues.
Savings of $65.5 million General Fund from reducing to $10.10 ($9.50 plus $.60 per hour for health benefits) the maximum provider wages the state participates in.
Elimination of eligibility, subject to exemptions, for domestic and related services or all services, for individuals whose needs were assessed to be below a specified threshold.[1]

The 2011-12 budget also established a pilot that requires DHCS to identify Medi-Cal beneficiaries at high risk of not taking medications as prescribed and to procure automated

[1] This reduction has been statutorily delayed until July 1, 2012, subject to a final court order upholding the policy. No updated estimate of the savings associated with the policy is available at this time.

machines to assist them. If the pilot and any enacted alternatives for achieving savings would not together result in $140 million General Fund, an across-the-board reduction in IHSS services, with specified exceptions, would begin October 1, 2012.

GOVERNOR'S 2012-13 BUDGET PROPOSALS:

Across-the-Board Reductions and Medication Dispensing: Although the 20 percent reduction in authorized hours is not occurring today because of the court order mentioned above, the budget assumes a full-year impact from the policy. At the same time, the Administration proposes a set-aside to fund the program in the event that the reduction continues to be enjoined. If the reduction takes effect, DSS anticipates that 233,000 recipients will lose the full 20 percent of their services in the budget year. Of the remaining recipients, the Department estimates that counties would partially restore hours for 152,000 clients and fully restore hours or exempt from the reduction 38,000 clients. The budget also proposes to repeal statutory requirements for the medication-dispensing pilot and associated across-the-board reduction trigger. DHCS indicates that further research led the Department to conclude that the pilot may not result in savings (and savings from a 20 percent across-the-board reduction are already included in the budget).

Proposed Move to Managed Health Care and Efforts to Better Coordinate Services: As described in greater detail in the Health section of this publication, the budget proposes to improve the coordination of certain health and social services by: 1) making long-term care and home and community-based services, including IHSS, benefits under managed health care, 2) expanding managed health care statewide, and 3) expanding a previously authorized demonstration project intended to better integrate services for individuals who are dually eligible for Medi-Cal and Medicare. The vast majority of IHSS recipients (85 percent) are dually eligible beneficiaries. All of these changes would happen simultaneously, though phased in at varying paces, through 2015. The budget does not propose any accompanying programmatic changes in IHSS in 2012-13 related to this policy. However, DHCS indicates that "over time, managed care plans will take on increasing responsibility for home and community-based services, including IHSS." The Administration has not yet specified what that increasing health plan responsibility over the long-term would entail or detailed how the IHSS program may or may not be altered as a result.

Proposed Restrictions on Domestic & Related Services: The budget proposes $210.5 million General Fund savings in 2012-13 from the elimination of domestic and related IHSS services for approximately 245,000 recipients who reside in shared living arrangements. Domestic and related services include housework, shopping for food, meal preparation and cleanup, laundry, and other shopping and errands. Currently, when IHSS beneficiaries reside in a shared living arrangement and some of their needs for domestic or related services are met by other household members (e.g., shopping is done in common), authorized hours for those services are pro-rated by county social workers based on the number of household members. The budget proposes to instead make IHSS beneficiaries residing in a shared living arrangement ineligible for domestic and related services. The proposal includes exceptions when all other household members are IHSS recipients or have medically verified conditions that prevent them from performing domestic and related services. The proposal extends to minor recipients with disabilities who live with their parent(s). The parent would be presumed available to perform these tasks unless the parent can provide medical verification of his/her inability to do so. The Administration made a substantially similar proposal last year, which was rejected by the Legislature.

ISSUES TO CONSIDER:

As indicated in the preceding section on Medi-Cal Managed Care, better integration of long-term care supports and services is a valuable goal and could improve care coordination. At the same time, the Administration's proposals to expand the use of managed care and to make IHSS a managed care benefit raise a number of significant, unanswered programmatic questions. These questions include whether and how that change might lead to future changes in: 1) consumers' ability to hire, fire and direct their care providers, 2) the assessment process for determining consumers' eligibility for services, 3) the scope and number of hours of IHSS services available, 4) the state and counties' roles in financing and overseeing care, 5) the employment relationships, wages, and benefits paid to providers, and 6) the outcomes and performance measures that would guide measurement of the program's success. Much of the policy governing these programmatic aspects is currently detailed in state law, and many potential changes in these areas would require statutory change. Some options for programmatic changes may also be constrained by requirements associated with federal funding for the IHSS program. The Administration acknowledges these questions and sets forth core values with which the Departments intend to approach them, including continued consultation with stakeholders and the protection of consumers' rights. But, while trailer bill language is not yet available, the Administration has thus far indicated that it does not anticipate making detailed proposals related to these long-term programmatic questions this year.

It is unclear whether the proposed elimination of domestic and related IHSS services for recipients who reside in shared living arrangements would comply with federal law and whether it accurately targets the reduction to recipients whose needs can be met in common. According to the Legislative Analyst's Office, Washington State recently enacted a restriction on domestic and related services for individuals who lived with their IHSS providers. The state's Supreme Court determined, however, that the policy violated federal requirements regarding the equal treatment of similarly situated Medicaid beneficiaries. Also, the Administration's proposal is predicated on an assumption that domestic and related responsibilities can be met in common in a household so long as the other residents are not also IHSS recipients and do not have a medically verifiable condition that prevents them from performing the tasks. There may be other circumstances in which household residents are not available, able, or willing to perform those services on the recipients' behalf. Some recipients could also have difficulty finding shared living arrangements (e.g., if unable to obtain their own groceries, safely prepare and clean up their own meals, or contribute to the upkeep of a household).

CalWORKs

BACKGROUND:

California Work Opportunities and Responsibilities to Kids (CalWORKs) provides cash assistance and welfare-to-work services to eligible needy families with children. The program supports 587,000 needy families with 1.2 million children[1] by helping them to attain self-sufficiency and by providing a safety net so that children can have their most basic needs met. Absent the Governor's proposals, CalWORKs would have a budget of $5.8 billion in combined federal, state, and local funds.

Some Information About CalWORKs Recipients:

- Nearly half (46%) of child recipients are under the age of 6.
- Around 27% of children who were served in the Child Welfare Services system were also served by CalWORKs.
- 92% of heads of recipient households are women. Two-thirds of them are single and have never married.
- Nearly half of these adults (41% of the 76% with data available) have 11th grade or less education, and 10-28% are estimated to have learning disabilities.
- Around 80% of these adults report experiencing domestic abuse at some point; and
- An estimated 19-33% have mental or emotional health problems.

Caseload and Spending Trends: Prior to federal welfare reform in the mid-1990s, California's welfare program aided more than 900,000 families. By 2000, the caseload had declined to 500,000 families. During the recent recession the caseload has grown; but at 587,000 cases, it has not returned anywhere close to the levels of the early 1990s. The caseload grew one percent in 2007-08, eight percent in 2008-09, ten percent in 2009-10, and six percent in 2010-11. Caseload growth has slowed to a projected two percent in 2011-12; and the Administration forecasts a small decline in 2012-13. According to the California Budget Project, welfare assistance represented 6.8 percent of the state's overall budget (including federal, state, and local resources) in 1996-97, compared with 2.9 percent in 2011-12.

Welfare-to-Work Caseload: In 270,000, or just under half of CalWORKs cases, families receive cash assistance for an adult (or adults) in addition to children. The adult's eligibility is subject to a lifetime limit of 48 total months. The overall average grant for recipient families is currently $471 monthly (up to a maximum of $638 for a family of three in a high-cost county). In approximately seventy percent of these cases, aided adults must participate in work

[1] Information about these families in the pull-out box comes from sample data collected by the Department of Social Services (DSS) & from studies in single or multiple counties, as summarized in *Understanding CalWORKs: A Primer for Service Providers and Policymakers,* by Kate Karpilow and Diane Reed. Published in April 2010; available online.

and other welfare-to-work activities[2]. To support that participation, the program offers these adults related services, such as childcare and transportation. In the other thirty percent of cases, the aided adult is exempt from work participation requirements for reasons such as disability or caregiving for an ill or incapacitated family member. Recipients who are exempt do not receive supportive services, and their time on aid does not count against the time limit.

Child-Only Caseload: In 315,000, or more than half of CalWORKs cases (called "child-only" cases), the state provides cash assistance on behalf of children only and does not provide adults with cash aid or welfare-to-work services. There is no time limit on aid for minors. The maximum grant for two children is $516 monthly. In most child-only cases (87 percent), a parent is in the household, but ineligible for assistance due to receipt of Supplemental Security Income, sanction for non-participation in welfare-to-work requirements, time limits, a previous felony drug conviction, or immigration status. In a minority of cases (13 percent), no parent is present, and the child is residing with a relative or other adult with legal guardianship or custody.

Federal Context: Federal funding for CalWORKs is part of the Temporary Assistance for Needy Families (TANF) block grant program. TANF was scheduled for reauthorization in 2010, but the federal government has enacted several temporary extensions since that time (the most recent through February 29, 2012). TANF currently requires states to meet a work participation rate (WPR) for all aided families or face a penalty of a portion of their block grant. States can, however, reduce or eliminate penalties by disputing them, demonstrating reasonable cause or extraordinary circumstances, or planning for corrective compliance. It is also important to note that federal formulas for calculating a state's WPR do not give credit for families who are partially meeting requirements. For example, a single-parent family with a work requirement of 30 hours in which the parent is working 25 hours per week is not counted as participating at all. According to the County Welfare Directors Association in 2009, data showed that 65 percent of adults the state required to work were participating, including 50 percent of work-required families who had employment earnings. As federally calculated, the state's WPR was 22.3, 25.1, and 26.8 percent in federal fiscal years 2007, 2008, and 2009, respectively. As a result, California did not meet its WPR requirements of 32.3, 29.0, and 29.0 percent for those years. The federal government did not assess a penalty for 2007. The state is, however, appealing penalties of $47 million and $113 million that were assessed for 2008 and 2009.

Recent Reductions: From 2009-10 through 2011-12, the budgets included significant ongoing, annual savings from long-term changes to CalWORKs policy. These reductions have included:

Policy	GF savings (in 000s)[3]
Suspension of an annual cost of living adjustment (COLA) and a 4% grant cut in 2009-10	$226,000
Additional 8% grant cut in 2011-12	$314,000
Reducing adults' lifetime time limit from 60 to 48 months	$104,000
Changes to earned income disregard	$83,000

2 Based on data from 2008-09. Does not take into account short-term reforms enacted in 2009 and authorized through July 1, 2012.

3 Savings figures are annual in the first full-year of implementation. On an ongoing basis, exact savings will vary with caseload and other policy changes.

From July 1, 2009 to July 1, 2012, short-term program changes have resulted in approximately an additional $375 million General Fund savings each year. These changes included temporary exemptions from welfare-to-work requirements for additional parents of young children (i.e., one child between the ages of 12 and 23 months or two children under the age of six), and a corresponding reduction in the costs of childcare and employment services funding. In 2011-12, the suspension of intensive case management services for pregnant and parenting teenagers through the CalLearn program resulted in an additional $43.6 million General Fund savings.

GOVERNOR'S 2012-13 BUDGET PROPOSALS:

The budget proposes to restructure the CalWORKs program and to significantly reduce the cash assistance and services available to most recipients. The Administration estimates that these proposals would result in $946.2 million net savings to the state.

Proposed Restructuring: The Governor proposes to create two new subprograms within CalWORKs--CalWORKs Basic and CalWORKs Plus--as well as a new Child Maintenance Program outside of CalWORKs. Effective October 1, 2012, the proposed **CalWORKs Basic** program would continue much of the current welfare-to-work program for eligible adults. However, assistance through CalWORKs Basic would be available for only 24 months in an adult's lifetime (compared with the current time limit of 48 months).

Adult recipients working sufficient hours (30 hours for single–parent families, 35 hours for two–parent families, and 20 hours for single–parent families with a child under the age of six) in <u>unsubsidized</u> employment would be eligible for 24 additional months (up to 48 months total) of cash assistance and some supportive services through **CalWORKs Plus**. With a more generous disregard of earned income, CalWORKs Plus would also allow recipients up to $44 more income per month before they would become ineligible. Children in these families would continue to qualify for this disregard after their parents time out of CalWORKs Plus. The Administration estimates that 25,500 families will qualify for CalWORKs Plus.

The proposed **Child Maintenance** program would include any families currently served in the CalWORKs child-only caseload, as well as 109,000 families in which the adult would lose eligibility under the Governor's proposals. Child maintenance grants would not be time-limited for minors. Compared with current child-only policies, the Child Maintenance program would require families to undergo eligibility determinations less frequently (from quarterly to annually), but would newly require proof that parents or caregivers have taken recipient children to annual well-child exams.

Families in the Child Maintenance program that include a work-eligible adult would be eligible for up to one month of child care to attend a job search program every six months. If the adult is working sufficient hours in an unsubsidized job and has time remaining on the 48-month time limit that applies to the CalWORKs Plus program, the family could also move to that program. If a sanctioned adult still has time remaining on the 24-month time limit for CalWORKs Basic, a family could move from Child Maintenance to that program after complying with a welfare-to-work plan for at least two months.

Proposed Changes to Time Limits and Services: In addition to the reduction from 48 to 24 months of the time limit for adults not working sufficient hours in unsubsidized employment, the Governor's proposal would narrow the scope of work activities that count toward meeting program requirements. Some activities that currently qualify under state, but not federal, definitions of work participation would no longer count. Those activities include, for example, adult basic education, higher education beyond 12 months of vocational training, and a longer time in which to participate in substance abuse, domestic violence, or mental health treatment. The Governor also proposes to apply the new 24-month time limit retroactively to all participating adults, as well as those whom the state previously exempted from work participation requirements and those whom the state stopped giving aid and services because they were sanctioned for non-participation. As a result of all of these proposed changes, in April 2013 (after six months of transitional services), the Administration estimates that 109,000 families in which the adult has reached the 24-month time limit for CalWORKs Basic without working a sufficient number of unsubsidized hours would transfer to the Child Maintenance program. The Administration also proposes to eliminate state support for intensive case management that was formerly available through CalLearn.

Proposed Reductions in Cash Assistance: The budget proposes a reduction of 27 percent in the maximum level of child-only grants available under the proposed Child Maintenance program. For a family with two recipient children (no aided adults), the maximum monthly grant would drop from $516 to $375. For the 109,000 families moving from CalWORKs to the Child Maintenance program, the loss of the adult portion of their grants would result in an even steeper loss. In a high-cost county, the maximum grant would drop from $638 for a family with three recipients (including one adult) to $375 for a family with two child recipients. As a result of the proposed lower grant levels, 63,000 recipient families with 125,000 children would lose all aid because their incomes would be too high for the resulting new eligibility thresholds. Additionally, the new program would reduce Child Maintenance recipient families' incomes by capturing for the state 100 percent of the child support payments made by non-custodial parents. Under the current program, the first $50 is passed through to the recipient family before the state begins to capture the support payments.

New Work Incentive Benefits Outside of CalWORKs: The budget proposes changes to the Work Incentive Nutritional Supplement (WINS) program that is currently scheduled to take effect by October 1, 2013, with full implementation by April 1, 2014. WINS is designed to provide a supplemental food benefit to working families who are receiving CalFresh, but not CalWORKs, benefits. To the extent that the state relies on TANF or TANF Maintenance of Effort (MOE) funding for the program, the Administration indicates that recipient families can be counted in federal work participation calculations. WINS was originally scheduled to begin in 2009-10, but has been statutorily delayed in recent years. The Administration proposes to increase from $40 to $50 the monthly supplemental benefit provided by the program. The Administration also proposes to expand WINS to low-income working families who receive subsidized child care, but not CalWORKs benefits, in a program called WINS Plus. DSS estimates that monthly caseloads for WINS and WINS Plus would be 95,000 and 25,000 respectively, beginning in 2013-14 (growing to 144,000 and 60,000 ongoing). Funding for implementation of the programs would include $45.2 million and $15.4 million General Fund in 2013-14 (growing to $88.9 million and $36.1 million on an ongoing basis). The Department estimates that implementation of these programs will result in a 15-20 percent increase in the state's WPR.

Effects on Work Participation Rates: Aside from the positive impacts of WINS described above, the Administration's proposal to redesign CalWORKs would result in only a potential minimal WPR increase in 2012-13. The Administration indicates, however, that if a separate Child Maintenance program could eventually be funded without TANF or TANF MOE, there could be a positive impact on the WPR at that point.

Funding Transfer: To achieve the proposed savings, the Governor's budget would transfer $736 million in TANF funds to the Student Aid Commission to offset a like amount of General Fund support for Cal Grants. According to the Administration, this would be an allowable use of TANF funds because support for low-income, unmarried students age 25 or younger could prevent and reduce out-of-wedlock pregnancies, which is one purpose of TANF.

ISSUES TO CONSIDER:

These proposals, which comprise a large portion of the reductions the Governor relies on to balance the budget, would result in a significant reduction of benefits and services to low-income families with children. At $638 per month for a family of three in a high-cost county, maximum CalWORKs grants (the grant level available for families without other income) are the same in actual dollars today as they were in 1987. After adjusting for inflation, the California Budget Project calculates that the purchasing power of these grants is already less than half of what it was in 1989-90. Said another way, if the slightly higher 1989-90 maximum grant of $694 had been adjusted for inflation every year, it would be $1,368 in 2012-13. When combined with CalFresh (formerly called food stamps) benefits, the proposed reductions to the maximum Child Maintenance grant would place families who receive it at 64 percent of the federal poverty level. As illustrated below, the proposed reductions would also change eligibility thresholds such that many families and children would lose all assistance.

<u>As Estimated for April 2013</u>

<u>CalWORKs Today</u>:

- 587,000 families with 1.2 million children
- 315,000 cases are child-only with max. grant for 2 children = $575/month
- Time-limit for adults is 48 months (no time-limit for children)

CalWORKs Basic: 128,938 families with adults and children aided; 24 month time-limit for adults

CalWORKs Plus: 22,445 families with adults and children aided; up to 24 additional months (48 total) for adults in unsubsidized jobs

Child Maintenance: 368,776 families with only children aided; max. grant for 2 children = $375/month

No longer assisted: 63,273 families with 125,000 children

The Governor's proposals change the rules retroactively and restrict the types of activities that adults can take advantage of to move from welfare to self-sufficiency. A significant number of adults who would lose CalWORKs eligibility after six transitional months are individuals whom the state previously exempted from work requirements (again, because of age, a disability, caregiving for an ill family member, etc). During the time they were exempt, these individuals did not receive welfare-to-work services and supports. Nonetheless, the proposed changes would require counties to go back and newly count that time against shorter time limits retroactively. In addition, aspects of the proposal to align state and federal policies would restrict participants' ability to count certain educational and other services (such as mental health and substance abuse services) toward work participation. Some of these activities would remain countable for only the 24 months in which participants can utilize the CalWORKs Basic program; others would be available for less time during those 24 months or no longer count at any time. The state has previously opted to allow for the broader array of these services with the goal of helping participants to overcome barriers that may otherwise prevent them from working.

These proposals come at a time when Californians, especially in low-income families, are facing high unemployment and rising poverty. According to the California Employment Development Department, unemployment rates for the state rose each year from 2007 to 2010, growing from 5.3 percent to 12.4 percent. Available monthly data for 2011 shows a seasonally adjusted unemployment rate of 11.8 percent in June and 11.3 percent in November. Some research on the effects of economic recessions indicates that it takes several years after a recession for employment to rebound and families to return to pre-recession income levels.[4] Further, low-income families are more likely to be unemployed than the workforce as a whole, and during economic downturns less educated workers sustain bigger job losses than those with more educational attainment.[5] Recent reports additionally indicate that women are recovering from the recession more slowly than men are, and that the economic downturn reduced employment for single mothers far more than it did for married parents.[6]

According to the U.S. Census Bureau, nearly one in four children in California (23 percent) was impoverished in 2010. This represents an increase from a low of 16 percent in 2001. Los Angeles County has also documented a 98 percent increase since 2006 (from approximately 5,500 to 11,000) in the number of homeless families receiving CalWORKs there. Research indicates that children who live in poverty are at significantly higher risk for health problems, lower educational attainment, and a number of other negative outcomes, well into their adulthood.[7]

---

[4] *The Effect of the Recession on Child Well-Being: A Synthesis of the Evidence by PolicyLab, The Children's Hospital of Philadelphia* (Foundation for Child Development; November 2010).

[5] Wonho Chung, Phil Davies, and Terry J. Fitzgerald, *Degrees of Job Security* (Federal Reserve Bank of Minneapolis: December 2010); available online at: http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4592.

[6] *Falling Behind: The Impact of the Great Recession and the Budget Crisis on California's Women and their Families* (California Budget Project; February 2012).

[7] *Turning Point: The Long Term Effects of Recession-Induced Child Poverty* (First Focus, May 2009); available online at http://www.firstfocus.net/library/reports/turning-point-long-term-effects-recession-induced-child-poverty.

SUBCOMMITTEE NO. 4

STATE ADMINISTRATION and GENERAL GOVERNMENT

State Administration and General Government

Information Technology

BACKGROUND:

The role of Information Technology for state operations has taken many transformations in the past several decades. The state's IT governance has largely been filled by a few attempts to react to situations overshadowed by a procurement scandal that left a large void where a central technology planning agency should have been present. For years many were left wondering why the state home to Silicon Valley was incapable of harnessing technology assets to develop a more cost efficient and effective government.

The passage of AB 2408 (Smyth), Chapter 404, Statutes of 2010, codified a cabinet-level agency to serve as the central IT organization to provide approval and oversight of all state information technology projects. More specifically, AB 2408 codified the Governor's 2009 Reorganization Plan that integrated the Department of Technology Services, the Telecommunications Division within the Department of General Services, and the information security functions previously provided by the Office of Information Security and Privacy Protection into the Technology Agency. AB 2408 also transferred duties related to IT procurement from the Department of Finance, Department of General Services, and the Department of Information Technology to the California Technology Agency. In addition to consolidating statewide IT functions under one cabinet-level agency, the legislation passed in 2010 was also responsible for coordinating activities of agency and department CIO's, and promoting the efficient and effective use of information technology in state operations.

According to an August 2011 report issued by the California State Auditor, the California Technology Agency currently oversees over 70 different IT projects totaling roughly $7.8 billion dollars over the lifetime of the projects. Under most circumstances, the information technology approval process begins with the host agency or department submitting a feasibility study report that is filtered through the Office of the Chief Information Officer and from there sent to the Department of Finance for the development of a budget proposal before the Legislature. Usually, the formal procurement process does not begin until funds have been allocated by the Legislature.

GOVERNOR'S PROPOSAL:

The Governor proposes $504.7 ($4.1 million GF) and 1,266.5 positions for the department. This budget reflects a $29 million dollar increase ($500,000 GF) over the 2011-12 budget. The 2012-13 budget request's $34.1 million in funding for an increase in data center workload and to replace various hardware and software components that are utilized by the agency. Additionally, the agency is requesting $2.5 million and six positions to offer continued technical support to the Employment Development Department and their identity management system.

ISSUES TO CONSIDER:

Further Consolidation of IT components in the state

In addition to reorganizing the state's IT governance structure; AB 2408 set forth four performance targets for the Technology Agency. Below is a table identifying the specific performance targets and the progress made by the Technology Agency (July 2011).

Area	Performance Target	Status (July 2011)
Reduce Energy Usage	20% by July 2011 30% by July 2012	37% reduction in energy usage From 170,000 MWh to 107,028 MWh
Network Consolidation	Begin migration to CGEN by July 2011	99.5% of network circuits in migration
Email Consolidation	Be in migration to shared e-mail solution by June 2011	99% of e-mail boxes in migration
Reduce Data Center Square Footage	50% by July 2011 (182,000 sq. ft)	44.7% reduced

According to the Little Hoover Commission, the agency has achieved an estimated $700 million dollars in savings by avoiding duplicative projects. While it is difficult to attribute the total sum of cost avoidance due to rejecting duplicative IT projects to the agency, it is safe to assume that the cross agency coordination undertaken by the Technology Agency has helped the state to realize better IT procurement practices in the short term. Additionally, consolidation of data centers and warehouses has led to cumulative cost savings of an estimated $75 million dollars. The Technology Agency is on the cusp of achieving the performance targets set forth by the Legislature. It may be wise for the Legislature to identify additional cost saving objectives for the agency to achieve in the near future.

IT Procurement Strategy

Large scale systems integration projects only comprise a small fraction of the overall number of contracts, yet the cost of these larger IT projects consume an outsized proportion of the state's IT budget annually. A 2009 report conducted by the LAO found that the state's use of a single, prescriptive, procurement process might not be the best fit for some IT projects, such as the larger, more complex projects that consume an outsized proportion of the state's annual IT procurement budget. The integration of larger, more complex IT systems might be able to avoid some cost overruns if the state were able to utilize a multi-stage procurement process that integrated multiple layers of review throughout the process. Unlike the more traditional contract award process that the state regularly uses; the multi-stage procurement process initially could have multiple vendors awarded contracts. These vendors would then be charged with building a small scale version of their product for review by the customer, who, in turn, would decide which vendor would be awarded with the full contract. Through increased dialogue and interaction it is likely that the state would achieve some cost reductions, yet, it is worth noting that the procurement timeline would likely need to be extended due to the nature of the contract. To achieve greater cost reductions in the IT procurement life cycle it might be wise for the Legislature to consider mechanisms, such as the LAO's proposal, that would enhance dialogue between the vendor and the customer/state entity.

Revenues

BACKGROUND:

The Governor and the LAO have both forecast modest growth in the economy. The Governor has projected that there will be very rapid growth in certain segments of the economy--particularly income for high-income taxpayers. Furthermore, the Governor assumes federal law will not change and the lower federal tax rates on regular and capital gains income will sunset at the end of 2012 causing some taxpayers to shift gains from 2013 to 2012. However, despite these few bright spots, the Governor's forecast reflects the lingering effects of the Great Recession with revenues that remain tens of billions below the amounts projected in 2007-08.

The State's General Fund revenues are generated primarily from the following three major tax sources:

- **Personal Income Tax (PIT)**. Over the past decade, the PIT has generated over 50 percent of the total GF revenues and is estimated to generate about $52 billion in the current fiscal year (not including the Governor's proposed tax changes). This is about the same level as was received in 2010-11 primarily because of a reduction to the PIT rate of 0.25 percent on every bracket that started in the 2011 tax year. The PIT is expected to account for over 60 percent of GF revenues in the budget year mainly due to the reduction in the State sales tax and the realignment of a portion of the State sales tax to the locals to fund the 2011 Public Safety Realignment. Taxes attributable to wages and salaries make up the vast majority of the GF revenues, but capital gains also can contribute a significant amount to PIT revenues. Also in the past decade, capital gains tax paid has ranged from $2.6 billion to nearly $12 billion.

  The PIT's proportion of GF revenues has grown steadily over the past decade and is proposed to make up 62 percent of the General Fund revenues in the budget year. This is mainly due to the policy decision to dedicate a portion of the sales tax to local governments to fund the 2011 Public Safety Realignment.

- **Sales and Use Tax (SU).** The SUT has generated about 30 percent of GF revenues over the past decade and is expected to generate around $19 billion in the current fiscal year. This is less than in prior years due to the expiration of the 1 percent temporary sales tax on July 1, 2011, that resulted in annual revenue loss of $5 billion. This is also due to the realignment of 1.0625 percent of the State sales tax to local governments to fund the 2011 Public Safety Realignment.

- **Corporation Tax (CT).** The CT has remained between 8 percent and 12 percent of state GF revenues over the past decade and is estimated to generate about $9.5 billion in the current year. This is less than the revenues collected from the corporate tax in the prior year and the Governor's revenue forecast for the budget year is for further declines in the corporate taxes paid. This is counter to rising corporate profits due to several corporate tax cuts implemented over the last several years. The corporate tax cuts that will result in fewer corporate tax revenues over the next several years include: (1) the change to an elective single sales factor apportionment that started in 2011; (2) the ability of unitary taxpayers to share tax credits among members of the unitary group that started in 2010; (3) the ability to carry back net operating losses to prior years, which will start in 2012; and (4) the end of the temporary suspension of net operating losses which was operative from 2008 through 2011. The LAO estimates that the revenue loss from these recent tax law changes will be over $1 billion in 2012-13.

GOVERNOR'S PROPOSAL:

Governor Proposes Temporary Taxes. The Governor is currently circulating a Constitutional Amendment that would raise the following revenues temporarily for five years starting in 2012:

- **Temporary Personal Income Tax Rates on Highest Income Californians**. The Governor's initiative would add three additional tax brackets. For single filers with income between $250,000 and $300,000 and joint filers with income between $500,000 and $600,000 an additional 1 percent would be applied to income above $250,000 and $500,000, respectively. Income between $300,000 and $500,000 for single filers and income between $600,000 and $1,000,000 for joint filers would be assessed an additional 1.5 percent. Finally, income over $500,000 for single filers and income over $1,000,000 for joint filers would be assessed an additional 2 percent. These changes are expected to raise $5.8 billion in revenues in the current and budget years combined.
- **Temporary Sales Tax Rate Increase of 0.5 percent**. The Governor's initiative would also temporarily raise the sales tax rate by 0.5 percent. This portion of the initiative is expected to generate $1.2 billion in additional revenues in the budget year.

Tax Enforcement. The Governor has proposed to build upon the successful implementation of the Financial Information Records Match (FIRM) program by the Franchise Tax Board (FTB). This program enables the FTB to compare financial records with debts owed the State to ensure collection. The Governor has proposed to expand FIRM to the Employment Development Department (EDD) and the Board of Equalization (BOE) beginning in 2013. This will enable EDD to collect unpaid wage withholding debts and the BOE to collect unpaid sales and use tax debts. These programs are expected to generate $15 million in the current and budget years.

Furthermore, last year, there was significant discussion about how to improve enforcement of use tax collection by firms that do not maintain an instate footprint (mainly Internet retailers). Ultimately, the implementation of the comprehensive enforcement effort enacted in June 2011 (Chapter 7x, Statutes of 2011 [AB 28x, Budget]) was delayed until later in 2012 by Chapter 313, Statutes of 2011 (AB 155, Calderon). The Governor's budget assumes that the tax enforcement changes included in the original bill will ultimately be implemented later in 2012 and will generate $50 million in additional revenues in the budget year.

Other Tax Policy Changes. The Governor has not proposed any other significant tax policy changes as part of the overall budget solution. However, the Governor's budget indicates that he will continue to pursue changing current law to make the multi-state corporate income apportionment method mandatory instead of elective and reforming the tax incentives that benefit enterprise zones. However, the Governor has indicated that he will pursue these policy changes separate from the budget, as part of a larger job creation effort proposed through policy legislation.

ISSUES TO CONSIDER:

Large Forecast Differences Due to Volatility of Capital Gains and Top Earners. The LAO's initial review of the Governor's Department of Finance's (DOF's) revenue projections are that they are approximately $3.9 billion higher over the three year period starting in 2010-11. Furthermore, because of differences in their expectations of revenues generated by the highest income earners, the LAO also has projected that the Governor's proposed Constitutional Amendment may generate about $2 billion less in revenues than projected by the Governor. These two factors account for a $6 billion spread between what the DOF has forecast and the LAO.

However, the vast majority of the differences are attributed to assumptions made around capital gains tax and the tax paid by the highest income earners. As noted in the background, tax revenues attributed to capital gains have been extremely volatile and have varied greatly over the past decade. Furthermore, the state has become more and more dependent on the tax revenues paid by the top one percent of taxpayers. In 1980, the top one percent of taxpayers had about 10.5 percent of total income. For 2010 the same top one percent of taxpayers now has over 22 percent of total state income. These two factors have made projecting income tax revenues extremely difficult and subject to error.

Corporate Tax Low and Could Get Worse (or Better). The LAO described in their November 2011 Fiscal Forecast the difficulty in projecting Corporate Tax (CT) accurately. First, there are significant lags in getting certain data related to CT, which hinders the ability to determine how recent policy changes have affected revenues. Second, the numerous policy changes outlined in the background section have made forecasting CT even more difficult. Historically, forecasters have used ratios between California taxable profits and national profits to determine trends. However, given the significant changes in tax policy and the volatility of the economy, these trends may be less useful in predicting revenues. Bottom-line, the CT forecast is subject to some uncertainty and despite corporate profit gains—there are significant downside risks from recent changes to corporate tax policy.

Tax Forecasts are Adjusted for Actual Tax Collections and Refunds. Tax payments and refunds are examined monthly to assess the accuracy of the revenue forecast. The January Governor's Budget revenue forecast is the starting point then the LAO releases an updated revenue forecast in February; and the Governor again releases a revenue forecast with the May Revision. Each subsequent forecast benefits from additional months of actual tax collection and refunds. Both the Controller and DOF release updates on tax collection in the first half of each month. Taxes are remitted in different ways – employment wages and bonuses are part of employer withholdings, which the employer remits to the state. Estimated quarterly payments are required for taxpayers that have capital gains or other significant income outside of wage earning. Sales taxes are remitted in monthly payments by retailers. Corporations make quarterly tax payments. Tax refunds are also tracked in monthly data for taxpayers who overpaid their tax. The following are some of the key tax dates that occur during the period of budget deliberations:

- **January 15**: Final quarterly estimated payments for personal income tax are due for the 2011 tax year.
- **January 31**: Final sales tax payments are due from retailers for the fourth quarter of 2011.
- **March 15:** Tax filing deadline for corporate taxpayers.
- **April 15:** Tax filing deadline for the personal income tax for the 2011 tax year, and due date for the first quarterly estimated payment for the 2012 tax year. For corporations that use calendar years for reporting, the first quarterly payment is due.
- **April 30:** Final sales tax payments are due from retailers for the first quarter of 2012.

Housing

BACKGROUND:

The state offers a variety of programs designed to support homeownership interests, increase the state's housing stock, and provide individuals with special needs a home. The majority of these programs are administered by the Department of Housing and Community Development and the California Home Financing Agency.

The mission of the Department of Housing and Community Development (HCD) is to help promote and expand housing opportunities for all Californians. As part of this mission, the department is responsible for administering a variety of housing finance, economic development, and rehabilitation programs. Some of the programs administered by the department, such as California Homebuyer's Downpayment Assistance, provide financial assistance so that low- and moderate-income families can purchase a home. While other programs, like Multifamily and Supportive Housing, provide assistance for the construction, rehabilitation, and preservation of permanent and transitional rental housing for low-income and disabled individuals and households. The department is also responsible for implementing and enforcing building standards.

In 2002 voters approved Proposition 46, which authorized a total of $2.1 billion in state bonds for a variety of new housing investments. Annual grant and loan awards increased and this was sustained in 2006 after the passage of Proposition 1C. The new bond measure authorized an additional $2.85 billion, most of which was again used to support affordable housing efforts. Nearly all of the funding from Proposition 46 has been allocated and there are only a limited amount of Proposition 1C funds remaining in the proposed 2012-13 budget year allocations.

The second largest revenue source is federal funding, estimated to be $189.9 million in 2012-13, which would be roughly the same as 2011-12. Remaining expenditures are comprised of fees, General Fund ($7.3 million), and other miscellaneous revenues.

Much of the federal funding is provided by the U.S. Department of Housing and Urban Development to support local Public Housing Authorities (PHA's). Public Housing Authorities are local agencies that are responsible for the administration of low-income federal assistance housing programs. There are currently over 100 Public Housing Authorities in the state. The Department of Housing and Community Development administers assistance to 12 rural counties that lack a local Public Housing Authority.

According to the most recent census data there are 466,244 households in California that rely on federal rental assistance programs to afford modest housing. The majority of the assistance provided by the Department of Housing and Urban Development is directed towards Housing Choice Vouchers. The Public Housing Authority calculates the maximum amount of housing assistance allowable. The maximum housing assistance is generally the lesser of the payment standard minus 30 percent of the family's monthly adjusted income or the gross rent for the unit minus 30 percent of monthly adjusted income. The PHA pays the landlord the remainder of the rent over the tenant's portion, subject to a cap referred to as "Fair Market Rent" (FMR) which is determined by HUD. Each year, the federal government looks at the rents being charged for privately owned apartments in different communities, and the costs of utilities (heat, electricity, etc) in those communities. The "Fair Market Rents" are an estimate of the average gross rents (rents plus utilities) for medium-quality apartments of different sizes in a particular community. As an example, 2012 FMR for 1 bedroom housing in Los Angeles-Long beach is $1159.

Additionally, the U.S. Department of Housing and Urban Development is responsible for the distribution of Community Block Development Grant funds. The Community Block Development Grant program provides block grants to local entities in order to fund redevelopment, economic development and the preservation/restoration of historic properties in low income neighborhoods. The Department of Housing and Urban Development distributed approximately $350 million dollars to both entitlement and non-entitlement entities (California Department of Housing and Community Development is responsible for the administration of funds for non-entitlement entities) for federal fiscal year 2012.

GOVERNOR’S PROPOSAL:

The Governor proposes $275.3 million ($7.3 million GF) and 542.1 positions for the department – a decrease of $351.4 million. The precipitous decrease in funding is largely reflected in the agency expending nearly all of the proceeds of the Housing and Emergency Shelter Trust Fund Act of 2006 (Proposition 1C).

The California Housing Finance Agency (CalHFA) receives its funding support from revenue bonds and is not subject to budget act appropriation. Originally chartered in 1975, the agency was created to serve as the state’s affordable housing bank in order to assist first time homebuyers by providing affordable mortgage loans. The agency produces an annual report and is subject to an audit conducted by an outside auditor each year. While not subject to budget act appropriation, their budget is presented for informational purposes. CalHFA will have $52.5 million dollars and 328.4 positions for the 2012-13 budget.

Proposition 1C Bonds (dollars in millions)

Program	Original Authority	Remaining	Approp Type	Total
Homeownership Programs				
Cal-Home	$290	-	Continuous	$290
Self-Help Housing	$10	-	Continuous	$10
Building Equity and Growth in Neighborhoods (BEGIN)*	$125	$26	Budget Act	$125
California Homeowners Down-payment Assistance Program (CHDAP) *	$100		Continuous	$100
Residential Development Loan Program (RDLP)	$100		Continuous	$100
Affordable Housing Innovation	$100		Continuous	$100
Subtotal	**$725**	$26		**$725**
Multifamily Rental Housing Programs				
Mutltifamily Housing Program (MHP) – General	$345	-	Continuous	$345
Supportive Housing	$195	-	Continuous	$195
Homeless Youth Housing	$50	$5	Continuous	$50
Subtotal	**$590**	**$5**		**$590**
Other Programs				
Serna Farmworker Housing Grant Program	$135	-	Continuous	$135
EHAP-CD	$50	-	Continuous	$50
Infill Infrastructure Grant	$850	$13	Budget Act	$850
Transit Oriented Development	$300	-	Continuous	$300
Housing Related Parks	$200	$161	Budget Act	$200
Subtotal	**$1,535**	**$174**		**$1,535**
TOTAL	**$2,850**	**$205**		**$2,850**

ISSUES TO CONSIDER:

Sources of Funding for Affordable Housing

Decreasing available bond proceeds coupled with the California Supreme Court's decision that resulted in the dissolution of redevelopment agencies has raised the question of where, or if, the state will be able to identify a funding source for affordable housing. Community Redevelopment Law had allowed a local government to establish a redevelopment area and capture all of the increase in property taxes that is produced within the area. The law was repealed with the dissolution of redevelopment. The Law required redevelopment agencies to deposit 20 percent of tax increment into a Low and Moderate Income Housing Fund to be used to increase, improve, and preserve the community's supply of low and moderate income housing available at an affordable housing cost. Statewide, Low and Moderate Income Housing Fund dollars have represented a significant source of funding for the construction, preservation, and rehabilitation of affordable housing.

The Legislature is currently considering legislation (SB 654) that would, among other things, allow a host city or county of a dissolving agency to retain the funds on deposit in the agency's Low and Moderate Income Housing fund. It is estimated that there is an amount in the range of $1 billion to $2 billion dollars in outstanding and unobligated balances in the Low and Moderate Income Housing funds maintained by redevelopment agencies throughout the state. Additionally, it would require the city or county to expend those funds in compliance with the housing provisions of the Community Redevelopment Law. Any funds that a city or county elected not to keep would be transferred to the Department of Housing and Community Development.

Excess Inventory Due to Foreclosures

Since 2008 the state's unemployment rate has nearly doubled. In addition to an increase in unemployment, the state has also seen a decrease in the rate of homeownership. In 2010 55.9 percent of households were homeowners, down by nearly 3 percent from the previous year. California remains one of the states with the highest foreclosure rates, yet there is often a mismatch between the current foreclosed housing stock, which is often larger and located in a suburban environment, and the demand for housing which is aligned with accessibility to jobs and a central location close to services.

Housing Voucher Assistance Limited

While housing starts continue to move forward at a record low pace, the need for affordable housing will persist. The foreclosure crisis has only exacerbated the need for rentals, as more individuals put off home buying due to the economic downturn. The Center for Budget and Policy Priorities reports that 1.4 million low-income renter households in California are paying more than half of their monthly cash income for housing costs. The federal vouchers do not come close to meeting the need for low-income housing in California. On average, these households have monthly incomes of $1,291 and pay housing costs of $1,143, leaving only $148 to pay for other necessities. Of the 1.4 million families paying more than half of their income towards housing costs, about 31 percent of these households are elderly or people with disabilities and 38 percent are families with children. Many of these jurisdictions have long waiting lists for a voucher. This leaves many households at risk of homelessness as reported in an LA Times article on January 18, 2012 the number of CalWorks families without a permanent place to live had increased nearly 100 percent in LA County.

Veterans

BACKGROUND:

There are approximately 2 million veterans living in the state, making California home to more veterans than any other state in the nation. The U.S. Department of Veterans Affairs regularly updates their statewide statistics; their most recent update (September 30, 2010) is below:

- Number of veterans – 1,971,959
- Total expenditures by the U.S. Department of Veterans Affairs in California - $9.1 billion
    - $3.8 billion in compensation and pension
    - $990 million in readjustment benefits
    - $3.9 billion in medical and construction programs
    - $170 million for insurance and indemnities
- Number of veterans receiving disability and compensation payments – 276,373
- Number of veterans using G.I. bill educational benefits – 46,897

The state performs three primary functions to support the needs of California's veterans and their families; guidance and representation through the disability and benefits claims process, direct loans for farms and homes, and long-term residential and medical care at one of the California Veterans Homes. The California Department of Veterans Affairs (CDVA), the agency charged with providing these benefits to the state's veterans, is designed to support the efforts of the United States Department of Veterans Affairs (USDVA) in providing healthcare and a wide array of other benefits to eligible veterans. The state and local government have long played an integral role in assisting the veteran access benefits provided by the USDVA, and, in some cases, provide additional benefits to returning service members. Recognizing that the state can provide an important service to veterans, the state has set aside funds to support the efforts of the USDVA and to also provide additional benefits, such as long-term residential care and the farm and home loan program.

The department operates veterans homes in Yountville, Barstow, Chula Vista, Ventura, Lancaster, and West Los Angeles. Homes in Redding and Fresno are under construction and were initially slated to open in 2012. These homes provide residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 62.

GOVERNOR'S PROPOSAL:

The Governor's budget proposes $362.3 million ($250.3 million GF) and 2,250.4 positions for the department. If implemented as proposed, General Fund support for the CDVA would increase from $217.1 million in 2011-12 to an anticipated $250.3 million in the budget year.

Summary of Expenditures (in thousands)

Fund Source	2011-12	2012-13
General Fund	$217,151	$250,331
Veterans Farm and Homebuilding Fund of 1943	$124,402	$103,938
Federal Trust Fund	$1,854	$4,305
Reimbursements	$1,497	$1,455
Other funds	$2,396	$2,274
Total	**$347,300**	**$362,303**

The Governor's budget includes a $27.8 million dollar increase to the General Fund due to adjusting staffing levels at the Redding, Fresno, and the Greater Los Angeles and Ventura County (GLAVC) Veterans homes. The Redding and Fresno Veterans Homes will be staffed only with personnel capable of maintaining a 'warm shutdown' while the GLAVC Veterans Home staff will be phased in at a slower pace than originally anticipated.

ISSUES TO CONSIDER:

Assisting veterans in obtaining federal benefits.
According to the statistics provided by the USDVA, 15.06 percent of the state's veterans are receiving disability or compensation benefits from the federal government, which lies slightly below the national average of 15.72 percent. Increasing the rate of participation rates for benefits has long been a goal of the Veterans Services division of CDVA. While the state does provide some funding for County Veteran Service Officers (CVSO's) to conduct outreach ($2.6 million dollars annually for all 54 counties) CDVA has limited influence on the outreach operations designed to connect the state's veteran population with federal benefits that they might be eligible to receive. Local agencies, such as CVSO's, or veteran specific non-profits have provided these services to veterans. A hurdle that the Veterans Services division often faces is that a CVSO's presence might vary by county, and are largely controlled by their respective county's board of supervisors. Therefore, the goals established by the CVSO's might not align perfectly with the goals of the Veterans Services division.

Unemployment

Each year, over 30,000 troops complete their military service and return to California. Between the often-difficult transition to civilian life and the struggling American economy, these new veterans are facing an uncertain economic future. Many Iraq and Afghanistan veterans leave the active-duty military only to find that their skills are not understood by civilian employers. Among Iraq and Afghanistan-era veterans of the active-duty military, the unemployment rate was over 20 percent in December of 2011, which is significantly higher than their civilian peers.

Looking at unemployment rates for veteran status shows that veterans have lower unemployment rates than nonveterans. However, the cumulative measurement masks the variations within the diverse group of veterans. Typically, young people have higher unemployment rates than do older people, and we see that reflected in the table below. However, young veterans are nearly twice as likely to be unemployed as their peers and the next peer group (ages 25-34) is only a slight improvement in employment rates for returning service members. The tables below identify the unemployment rate for veterans by age group and by conflict.

Unemployment Rates of Californians Age 20 and Over by Veterans Status

(November 2011; 12-Month Average of Current Population Survey of Households Data)

	All Persons	Non-Veterans Only	Veterans Only
All Ages, 20+	**11.0%**	**11.0%**	**10.8%**
Age 20-24	17.7%	17.5%	34.0%
Age 25-34	11.6%	11.4%	18.7%
Age 35-44	9.5%	9.5%	11.2%
Age 45-54	10.0%	10.1%	8.7%
Age 55-64	9.3%	9.3%	9.3%
Age 65+	9.5%	10.1%	7.2%

	Labor Force	Employed	Unemployed	Unemployment Rate
All Veterans	869,048	800,258	93,790	10.5%
OIF/OEF	116,224	90,872	25,352	21.8%
Gulf War I	157,915	142,401	15,514	9.8%
Vietnam Era (1964-1975)	294,492	272,357	22,135	7.5%

Source: Current Population Survey, U.S. Bureau of Labor Statistics

Compiled by: California Employment Development Department

Local Mandates

BACKGROUND:

Budget funding for non-education mandate payments to local governments is included in the budget of the Commission on State Mandates (Commission). The Commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution. Payments for mandate costs incurred prior to 2004 are one exception noted in the Constitution and pre-2004 mandate costs can be repaid over time. Another exception in the Constitution is for mandates related to labor relations – the State can defer payment of these mandates and still retain the mandate requirements in effect.

Mandates reimbursement claims are filed with the Commission for the prior fiscal year – after that fiscal year is completed and actual costs are known. The state pays the mandate claims in the next fiscal year. For example, local costs incurred in 2010-11 will be reported and claimed in 2011-12, and the state will reimburse locals for these costs in the 2012-13 budget.

Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment. For example, several elections-related mandates were suspended for the first time in the 2011-12 budget – this means the activities for locals are optional in 2011-12 and locals cannot claim reimbursement for any new costs incurred in 2011-12. However, the mandate claims for these costs in 2009-10 and 2010-11 are still due – either over time, or all at once in a year when the mandate suspension is lifted.

The State owes local governments approximately $1.6 billion in non-education mandate payments. Of this, about $900 million is associated with pre-2004 mandate claims.

GOVERNOR’S PROPOSAL:

The Governor’s Budget proposed expenditures of $52.9 million ($50.4 million General Fund) related to non-education mandates, and this includes $1.5 million for the staff of the Commission. The Governor’s budget would continue to fund the 12 mandates that were kept in force for 2011-12, and that makes up the bulk of the General Fund cost – a list of those mandates is below.

Proposed Mandate Funding in Governor's Budget—General Fund
(Mandates to stay in effect, with reimbursement required)

Mandate Title	Amount (1,000s)
Allocation of Property Tax Revenue	$727
Crime Victim's Domestic Violence Incident Reports	167
Custody of Minors-Child Abduction and Recovery	12,999
Domestic Violence Arrests and Victim's Assistance	1,374
Domestic Violence Arrest Policies	7,608
Domestic Violence Treatment Services	1,944
Health Benefits for Survivors of Public Safety Officers	1,695
Medical Beneficiary Death Notices	10
Peace Officer Personnel Records	657
Rape Victim Counseling	349
Sexually Violent Predators	20,963
Threats Against Police Officers	26
Unitary Countywide Tax Rates	267
Total	**$48,786**

Repeal of Mandates. The Governor does not propose to reactivate any mandates, but would repeal 32 of 56 currently suspended mandates. Repealing mandates does not offer any additional budget savings relative to suspension; however, if the mandate will otherwise be suspended indefinitely, the repeal of statutory provisions cleans up the code and provides more certainty to local governments.

Budget Savings. The Governor scores a total of $828 million in mandate savings from maintaining mandate suspensions – or repealing those suspended mandates, and by continuing other savings measures. The savings breakdown is as follows: (1) savings of $99.5 million by deferring payment of pre-2004 mandate claims; (2) savings of $295.1 million by deferring payment of post-2004 mandate claims for mandates that have since expired or been repealed; (3) savings of $375.7 million by continuing the suspension of certain local mandates, or repealing them; and (4) savings of $58.0 million from keeping employee-rights mandates in effect, but deferring payment. Under (3) above, 56 mandates are proposed for continued suspension or repeal – excepted are the 12 mandates listed above related to law enforcement and tax collection.

ISSUES TO CONSIDER:

The Governor's mandate proposal is a continuation of the status quo in terms of mandates in effect and mandates not in effect. The big difference in this year's proposal is the Governor's request to amend statute to repeal 32 of the 56 mandates currently suspended. The difference between suspension and repeal does not affect budget savings because in either case the activity becomes optional for local governments and the state does not have to reimburse costs. The argument for repeal is that if the mandate will continue to be suspended in the foreseeable future, the statutory provisions should reflect that the activity is no longer required. Since the list is long, the 32 mandates are not listed here, but are included in the back of this report.

In considering the proposal to repeal 32 mandates, the Legislature can consider whether the activity is a high-priority for the State budget, or will in a future year rise to that level when the state's budget is improved. Additionally, the Legislature can consider that locals government have themselves placed a high priority on some of these activities and will in many cases continue the functions regardless of whether the State reimburses the costs.

General Obligation Bonds

BACKGROUND:

The State uses general obligation bonds (GO bonds) to borrow funds for spending – primarily on capital infrastructure. Bonds must be approved by voters and bond proceeds are either continuously appropriated (immediately available for expenditure) or require a legislative appropriation. All bond debt service is continuously appropriated and, therefore, not appropriated in the annual budget bill. According to the Administration, the State has $81.0 billion in outstanding GO bond debt (including self-liquidating bonds like the Economic Recovery Bonds). Another $35.3 billion in bonds are authorized, but unissued. In most instances, bonds are sold at different lengths of maturity such that repayment is spread over about 30 years.

General Obligation Bonds Authorized but not Issued

Bond Program	Unissued Amount (in millions)
Prop 1B of 2006: Transportation	$11,080
Prop 1A of 2008: High Speed Rail	9,448
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	3,362
Prop 84 of 2006: Safe Drinking Water	2,957
Prop 71 of 2004: Stem Cell Research	1,873
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,819
Prop 46 of 2002 & Prop 1C of 2006: Housing	1,392
All other	3,372
TOTAL	**$35,303**

The State generally goes to market to sell GO bonds once in the spring and once in the fall. Bonds are sold to meet expenditure needs plus an additional cash cushion to account for uncertainty about how fast projects will expend funds and uncertainty about the timing of the next bond sale. As of December 2011, about $9.7 billion in bond cash was on-hand from prior bond sales. The table below shows cash on-hand by bond for some of the major bond acts.

General Obligation Cash Proceeds

Bond Program	**Cash, or bond proceeds, as of Dec 2011 (in millions)**
Prop 1B of 2006: Transportation	$2,241
Prop 55 of 2004 & Prop 1D of 2006: Education Facilities	1,501
Prop 1E of 2006: Disaster Prep and Flood Prevention	1,445
Prop 84 of 2006: Safe Drinking Water	1,291
Prop 46 of 2002 &Prop 1C of 2006: Housing	654
Prop 71 of 2004: Stem Cell Research	187
Prop 1A of 2008: High Speed Rail	216
All others	2,166
TOTAL	**$9,701**

GOVERNOR'S PROPOSAL:

Expenditure of bond proceeds is reflected in the budgets of individual departments, but the payment of bond debt is consolidated in item 9600 in the Governor's Budget. It is the repayment of bond debt that is reflected as a General Fund expense. Some bond costs are offset by special funds or federal funds. Other bonds are "self liquidating," or have their own dedicated revenue (i.e., the Economic Recovery Bonds [ERBs] receive a quarter-cent of the sales tax).

The January Governor's Budget includes $4.6 billion in General Fund costs for GO bond debt service and related costs, or a total of $6.1 billion when the cost of Economic Recovery Bonds is included. In addition to this amount, $717 million in debt costs are funded from special funds (i.e., $703 million from transportation special funds is used to pay transportation-related bond debt). Finally, federal bond subsidies, through the Build America Bonds (BABs) program, provide $352 million in 2012-13.

Governor's Budget for GO Bond Debt
(Dollars in millions)

	2010-11 Actual Cost	**2011-12 Estimated Cost**	**2012-13 Estimated Cost**
General Fund cost	$4,747	$4,649	$4,612
Other funds cost	732	679	717
Federal subsidy (Build America Bond Program)	298	351	352
TOTAL Item 9600	**$5,777**	**$5,679**	**$5,681**
Economic Recovery Bonds (ERBs, not included above because indirect GF cost)	$1,263	$1,341	$1,465

The Governor's proposed budget includes $92.6 billion in General Fund expenditure, so the net General Fund bond debt service as a percentage of General Fund expenditures is 5.0 percent (or 6.6 percent when ERBs are included).

Economic Recovery Bonds are not included directly in General Fund costs for bond debt service. Repayment of those bonds is financed from a quarter cent sales tax that was temporarily redirected from local government. Local government revenue is backfilled from the State General Fund through Proposition 98 education funding. The budget reflects special fund expenditures of $1.5 billion for ERB debt service in 2012-13, and the Proposition 98 budget reflects increased General Fund expenditures of $1.4 billion. The difference is due to timing issues and also the fact that revenue from surplus property sales is also used to accelerate ERB repayment.

The budget plan includes an assumption that $2.4 billion in GO bonds will be sold in the spring of 2012, and that $2.9 billion will be sold in the fall of 2012. Among these planned sales are $2.4 billion for Proposition 1B (transportation) and $1.9 billion for various education facility bonds.

ISSUES TO CONSIDER:

Budget and Bonds

Paying GO bond debt is a significant General Fund expense of about $6.1 billion; however, the use of bonds to accelerate capital projects is a commonly-used practice of government entities. To the extent bond costs do not exceed a government's long-term ability to fund other commitments, they allow the public to enjoy the benefits of infrastructure investment more quickly. Voters approved over $40 billion in new bonds on the 2006 ballot, just prior to the national recession. The bonds have allowed the state to invest in infrastructure while the need for economic stimulus is most acute, while borrowing costs are low, and while construction procurement is favorable. Despite the benefits of bonds, they come with the cost of many years of debt service. A $1 billion bond generates annual bond debt costs of about $65 million over a 30-year period. That bond cost crowds out alternative expenditures over the life of the bond. The Legislature can prioritize or limit bond funding through the budget process as overall expenditures are prioritized.

Management of Bonds

As the State's cash situation deteriorated with the most recent recession, the Administration changed the methodology for managing bond cash. Prior to the recession, reserve cash funded project costs in advance of bond sales, and then bond sales replenished cash reserves. When reserve cash declined, the state had to instead sell bonds in advance of expenditures. Due to project expenditures happening slower than anticipated at the time of bond sales, large bond cash balances have developed – about $9.7 billion as of December 2011. Last year, the Administration implemented a plan to utilize commercial paper to aid cashflow, and reduce the need to carry large bond cash balances. Progress has been made to reduce bond cash, but balances are still higher than desired. At budget hearings, the Administration should be prepared to discuss their management of bond proceeds and forecasts of project expenditures.

Budgetary Borrowing and Loan Repayment

BACKGROUND:

Through budget actions over the last decade, the State has borrowed from special funds and deferred payments to close budget deficits. The Department of Finance indicates a total of $33.5 billion in loans and deferrals have accumulated and remain unpaid. The Governor defines this as the "wall of debt," and includes in his definition adjustments related to his budget proposals. Some obligations require repayment in specified years due to constitutional requirements or due to scheduled bond debt service – examples of rigid repayment requirements are a payment of $2.1 billion in 2012-13 for "Proposition 1A" local-government borrowing and an Economic Recovery Bond payment of $1.4 billion also in 2012-13. Other debt payments are more flexible, for example school payment deferrals and special fund loans can be repaid over time as the budget situation dictates. In either case, the wall of debt represents a budget challenge as these accumulated debts make it more difficult to fund ongoing program costs.

GOVERNOR'S PROPOSAL:

The Governor proposes to pay down $6.9 billion of the $33.5 billion wall of debt in 2012-13. The Governor's multi-year budget plan assumes voter approval of his tax initiative and if that occurs, his plan would fully repay wall-of-debt obligations by the end of 2015-16. If this plan were to be realized, the 2016-17 budget and ongoing budgets would be free of these debt pressures and expenditures would be more in line with annual revenues.

Governor's Wall of Debt and Proposed Repayment
(Dollars in Millions)

Wall of Debt Item	Outstanding Balance	Proposed Repayment in 2012-13
Deferred Payments to Schools	$10,430	$2,369
Economic Recovery Bonds	6,081	1,362
Loans from Special Funds	3,101	486
Mandate Debt to Local Governments	4,472	0
Underfunding of Proposition 98	4,113	462
Proposition 1A Borrowing from Local Governments	2,095	2,095
Deferred Medi-Cal Costs	1,625	0
Deferral of State Payroll Costs	759	0
Deferred Payments to CalPERS	501	0
Proposition 42 Borrowing from Transportation Funds	334	83
Total	**$33,511**	**$6,857**

The payments related to schools are discussed in the education section of this report. The planned payments for Economic Recovery Bonds, Propositions 1A borrowing, and Proposition 42 borrowing are constitutionally required or dictated by bond debt service. The payment of loans from special funds, is more discretionary. In fact, the base budget, or workload budget, assumed total loan repayment of $1.1 billion in 2012-13, but the Governor proposes to defer payment of $631 million of that outstanding debt until future years. The amount of special-fund loans proposed for repayment is $486 million, plus interest costs of $39 million. The Administration indicates repayment of these loans is necessary to support 2012-13 expenditures in those departments funded with the associated special fund revenue. Interest is required on most special fund loans and is paid when the principal is repaid.

Governor's Proposal for Repayment of Special Fund Loans
(Dollars in Millions)

Affected Department and Special Fund	Principal Amount	Interest Amount
Technology Agency – State Emergency Telephone Number Account	$28.0	$0.2
Consumer Affairs – Behavioral Science Examiners Fund	2.0	0.5
General Services – Public School Planning Revolving Fund	10.0	1.3
Housing and Community Development – Joe Serna, Jr. Farmworker Housing Grant Fund	2.5	0.3
Housing and Community Development – Rental Housing Construction Fund	0.5	0.1
Transportation – State Highway Account	135.0	5.6
Conservation – Collins-Dugan California Conservation Corps Account	2.0	0
California Energy Commission – Renewable Resources Trust Fund	64.1	7.2
California Energy Commission – Alternative and Renewable Fuel and Vehicle Technology Fund	8.3	0.3
Cal Recycle – California Beverage Container Recycle Fund	171.7	13.8
Public Utilities Commission – California Teleconnect Fund	61.8	9.3
Total	**$485.9**	**$38.6**

ISSUES TO CONSIDER:

The Governor's emphasis on repaying budgetary debt over the next four years is good fiscal policy that also complements his initiative to temporarily increase taxes for four years. Clearing $33.5 billion in budgetary debt while temporary taxes are in place will reduce spending pressures after the taxes expire. While some of the Governor's debt repayment is constitutionally mandated in 2012-13, other debt can be considered within the context of the Legislatures other budget priorities. However, due to the budget gap, it would be difficult to accelerate debt repayment beyond the level proposed by the Governor. In considering repayment of special fund loans in 2012-13, and beyond, the Legislature should consider the expenditure needs of the affected departments and programs. Some department may have deferred capital projects or maintenance that can be accelerated by early loan repayments. Other departments may not have spending pressures, and funds from repaid loans may result in surplus reserves over a period of many years.

Cash Management

BACKGROUND:

Because receipts and disbursements of cash occur unevenly throughout the fiscal year, the General Fund borrows for cashflow purposes in most years, even though each budget is balanced when enacted and funds are repaid within the fiscal year. Interest is paid on both internal borrowing (such as cashflow loans from special funds) and for external borrowing (such as Revenue Anticipation Notes [RANs]). An additional tool in managing cash is deferrals of payment within the fiscal year to universities, local governments, and other entities. In recent years, flexible deferrals have been enacted in statute that allows specified deferrals if necessary to maintain a prudent balance for bond debt and other priority payments.

GOVERNOR'S PROPOSAL:

The Governor's proposal includes funding for the interest costs of cashflow borrowing from special funds and from RANs. The budget includes $178 million General Fund for these interest costs. In addition to interest costs, which are continuously appropriated (RANs) and appropriated in the budget bill (special fund cash loans), the Governor proposes statutory change that would allow additional special funds to be authorized for cashflow borrowing and statutory change to continue flexibility to defer specified payments if needed for cash management. These statutory flexibilities are similar to what current law provides for 2010-11 and 2011-12.

Cashflow borrowing. The Administration proposes to make seven special funds eligible for cash borrowing, which would provide about $865 million of new borrowable resources. Five of the seven funds are transportation special funds which were restricted in use by Proposition 22 on the 2010 ballot. The proposed changes would further the purpose of Proposition 22, by providing new benefits and flexibility for transportation funds – specifically emergency borrowing authority in the case of delayed bond sales, and guaranteed allocations to local governments even in the case of late budgets. Proposition 22 funds would be made borrowable to provide a $625 million cashflow benefit. The other two special funds that would be available for cash borrowing are the Condemnation Deposits Fund and the Health Care Deposit Fund. All cashflow borrowing is managed so that programs supported by the special funds are completely unaffected.

Flexible Payment Deferrals. The proposed legislation to continue payment-deferral flexibility would provide over $3.4 billion in cashflow relief. The deferral plan was developed in consultation with higher education and local governments to minimize negative consequences. Finally, the plan includes triggers, such that the deferrals will not occur if the team of the State Treasurer, the State Controller, and the Director of Finance concur they are not necessary to maintain cash balances for the State. The following are the major statutory components:

- K-12 Education – Permits deferrals in specified months with specified repayment dates. The amount deferred in any period prior to repayment cannot exceed $1.9 billion. Includes a hardship-exemption process for certain local education agencies.
- Community College – Permits deferrals up to $300 million.
- California State University – Permits deferrals of up to $250 million, and specifies smoothing of payments to the California State University such that the monthly payments in July through April do not exceed one-twelfth of the annual amount.
- University of California – Specifies smoothing of payments to the University of California such that the monthly payments in July through April do not exceed one-twelfth of the annual amount.
- Cities and Counties – Permits deferrals of specified payments to local governments not to exceed $1 billion.

ISSUES TO CONSIDER:

Authorizing additional special funds for cashflow borrowing is good fiscal policy that reduces the need for more expensive external borrowing. While cash deferrals to other government units are not desirable, the flexibility to do so may be necessary for 2012-13 to maintain a prudent cash cushion that is need to obtain external borrowing. Deferrals to public entities also ensure payments to private vendors and tax refunds will not be delayed. The Governor's plan to reduce the wall of debt will help the state's cash management and reduce the need for payment deferrals in the future.

SUBCOMMITTEE NO. 5

CORRECTIONS, PUBLIC SAFETY, THE JUDICIARY,
LABOR and PUBLIC EMPLOYEES

Trial Court Funding

BACKGROUND:

Chapter 850, Statutes of 1997, enacted the Lockyer-Isenberg Trial Court Funding Act of 1997 to provide a stable and consistent funding source for the trial courts. Beginning in 1997-98, consolidation of the costs of operation of the trial courts was implemented at the state level, with the exception of facility, revenue collection, and local judicial benefit costs. This implementation capped the counties' general purpose revenue contributions to trial court costs at a revised 1994-95 level. The county contributions become part of the Trial Court Trust Fund, which supports all trial court operations. Fine and penalty revenue collected by each county is retained or distributed in accordance with statute.

Chapter 1082, Statutes of 2002, enacted the Trial Court Facilities Act of 2002, which provided a process for the responsibility for court facilities to be transferred from the counties to the state by July 1, 2007. This Chapter also established several new revenue sources, which went into effect on January 1, 2003. These revenues are deposited into the State Court Facilities Construction Fund (SCFCF) for the purpose of funding the construction and maintenance of court facilities throughout the state. As facilities transfer to the state, counties will also contribute revenues for operation and maintenance of court facilities based upon historical expenditures.

In enacting these changes, the Legislature sought to create a trial court system that was more uniform in terms of standards, procedures, and performance. The Legislature also wanted to maintain a more efficient trial court system through the implementation of cost management and control systems.

The Judicial Council is the policymaking body of the California courts, the largest court system in the nation. Under the leadership of the Chief Justice and in accordance with the California Constitution, the council is responsible for ensuring the consistent, independent, impartial, and accessible administration of justice. The Administrative Office of the Courts (AOC) implements the council’s policies.

Currently, the state maintains 58 trial court systems, each having jurisdiction over a single county. These courts have trial jurisdiction over all criminal cases (including felonies, misdemeanors, and traffic matters). They also have jurisdiction over all civil cases (including family law, probate, juvenile, and general civil matters). In 2009–10, more than ten million cases were filed in trial courts throughout the state.

Major Trial Court Realignment Legislation

Legislation	Description
Lockyer–Isenberg Trial Court Funding Act of 1997. Chapter 850, Statues of 1997 (AB 233, Escutia and Pringle)	Transferred financial responsibility for trial courts (above a fixed county share) from the counties to the state.

Legislation	Description
Trial Court Employment Protection and Governance Act. Chapter 1010, Statutes of 2000 (SB 2140, Burton)	Classified most individuals working in the trial courts as court employees.
Trial Court Facilities Act of 2002. Chapter 1082,Statutes of 2002 (SB 1732, Escutia)	Initiated the transfer of ownership and responsibility of trial court facilities from the counties to the state.

GOVERNOR'S PROPOSAL:

The Governor proposes $50 million for the Trial Court Trust Fund from civil court fee increases. These funds would be available to offset the ongoing impact of reductions in funding for trial court operations contained in previous budget acts. Additionally, the budget includes a provision that would grant the Judicial Council the authority to allocate the continuing budget reductions across the branch, and to redirect funding from other court fund sources, as the Judicial Council deems appropriate.

The following shows total trial court funding assumed in the budget since 2008-09. More offsets than reductions in some years are due to previous reductions being one-time in nature.

(dollars in millions)

2010-11	2011-12	2012-13
$3,218	$2,667	$2,819

The Governor proposes a trigger reduction of $125 million if the Governor's tax proposal is not approved in November. While the Branch would determine how to implement this reduction, it is the equivalent of court closures equal to three days per month.

ISSUES TO CONSIDER:

Recent reductions in trail court funding. Although trial courts have experienced reductions in General Fund support in the past several years, these reductions have been largely offset by fund shifts and additional revenue from court-related fee increases. As a result, although cumulative reductions currently stand at $605.8 million, the total level of funding for trial courts has remained relatively flat in recent years. For instance, in 2010-11, trial courts actually received an increase in funding as compared to 2009-10 and the actual funding reduction allocated to trial courts for 2011-12 was $138.3 million.

Following is a summary of reductions and offsets to trial court funding since 2008-09.

(dollars in millions)

Trial Court Reductions	2008-09	2009-10	2010-11	2011-12
Unallocated Reduction	$92.2	$268.6	$55	$320
One-time Reduction		(100)	(30)	
Total	**$92.2**	**$268.6**	**$55**	**$320**
Offsets	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Use of Local Reserves	$92.2	$71	$25	$0
Transfer From other Funds		130	130	233.0
Fee Increases		46.7	113.2	107.1
Use of Fund Reserve		3	36	69.4
Total	**$92.2**	**$250.7**	**$304.2**	**$409.5**

Although funding reductions have been largely offset in the past, many of the sources used for these offsets have been exhausted. Additionally, although some funding for employee benefit cost increases has been provided, trial courts have not received an inflation or cost-of-living adjustment since 2008-09 ($70.1 million Consumer Price Index adjustment), which increases the pressure on trial courts to provide a sustained level of service.

Previous reductions continue to impact trial court services. Under Government Code (GC) section 68106, courts must provide written notice to the public and to the Judicial Council at least 60 days before instituting any plan to reduce costs by designating limited services days. The council, in turn, must post all such notices on its internet site within 15 days of receipt. Since GC Section 68106 became operative on October 19, 2010, the Judicial Council has received the following notices from 24 courts:

County	Notice
Alameda	Clerk office hours reduced an hour and a half.
Butte	Closed Paradise Courthouse, which only offered counter services.
Calaveras	Clerk office hours reduced an hour and 15 minutes.
Fresno	Due to staffing shortages, closed four courts during parts of the last two weeks of December 2011.
Humboldt	Clerk office hours reduced by two hours.
Kings	Changed Avenal courtroom proceedings schedule from every Wednesday (1/2 days) to every other

County	Notice
	Wednesday (full-days). Closed three courthouses from December 27, 2011 through December 30, 2011.
Lake	Will close clerk's office and all courtrooms for a total of 13 days in the current fiscal year, which are unpaid furlough days for all employees.
Lassen	Clerk office hours reduced by two hours.
Mendocino	Changed calendar schedule for Covelo and Point Area Courts from one time per month to one time every other month. Clerk office hours reduced by one hour.
Merced	Clerk office hours reduced by one hour. Implemented limited operation days for seven days in November and December 2011, which included closure of all clerk's offices and all but two courtrooms.
Nevada	Reduced clerk's office and courthouse hours by two hours each Friday.
Placer	Will Close clerk's office and courtrooms for 12 days during the current fiscal year. On one of these days, a single courtroom will remain open to handle certain criminal/juvenile matters.
San Bernardino	Closing the Big Bear Courthouse and Needles Courthouses for two day per month.
San Francisco	Closed 14 civil courtrooms.
San Joaquin	Closed the Tracy Court Branch and one courtroom and one clerk's office at the Lodi Court branch.
San Luis Obispo	Closed the Grove Beach Courthouse.
San Mateo	Closed the Northern Branch satellite office, which handled certain family law, probate, and civil filings. Closed Courtroom G at the San Mateo Court Central Branch on Tuesdays and Thursdays. Revised traffic arraignment calendar process. Clerk office hours reduced by one hour.
Santa Clara	Clerk office hours at the Santa Clara Courthouse reduced by three hours Monday through Thursday.
Santa Cruz	Implementing four limited service days during the current fiscal year.
Shasta	Clerk office hours at the Burney Branch location reduced by two hours.
Siskiyou	Discontinued one-day per month court sessions in Tulelake.
Tehama	Clerk's office hours reduced by one hour Monday

County	Notice
	through Thursday.
Ventura	Clerk's office hours reduced by one hour. Limited court closures on six days in November and December 2011. Reassigned its two East County Civil Law Judges and related clerk services at the Simi Valley location, except for unlawful detainers, family law and small claims.
Yolo	Clerk office hours reduced by two hours. Reduced calendar from December 19, 2011 through December 30, 2011.

In addition to the notices listed above, efforts to reduce trial court expenditures have led to staffing reductions, including.

- San Joaquin Superior Court, which recently laid off 42 employees.
- San Francisco Superior Court, which recently laid off 75 employees.
- Los Angeles Superior Court, which previously laid off 329 employees.

Many one-time offsets have been exhausted. As mentioned previously, reductions in funding for trial courts have largely been offset by fund shifts or transfers, use of local funding reserves, fee increases, and court closures. Other than fee increases, many of these offsets have been one-time in nature and may no longer be feasible options to mitigate the impact of previous reductions in trial court funding.

The AOC has indicated that trial courts can operationalize a significant amount of the funding reductions contained in prior budgets. However, the AOC also indicates that, without some level of restoration, trial court services will be further impacted.

Judicial Branch proposed solutions for trial court funding. The AOC has proposed that the following solution be considered as a package of components that can provide ongoing funding stability for trial courts.

- **Establish a New Baseline Budget That Reflects an Appropriate Level of Ongoing Funding Based on Cumulative Reductions.** Trial courts will absorb approximately $350 million as operationalized reductions while recognizing that courts may be unable to provide full access to justice. This is an attempt to more accurately reflect the budget after the successive years of one-time borrowing solutions.

- **General Fund Restoration.** Part of the ongoing solution would include a restoration of $150 million. This restoration is proposed to be made over the next three fiscal years: $100 million in 2012-13, another $25 million in 2013-14, and a further $25 million in 2014-15.

- **Additional and/or Increases in Various Civil Fees.** As done in past years, the judicial branch will work with the other branches of government and judicial branch stakeholders, including the State Bar, to develop a range of user-fees. As mentioned above, the proposed budget includes $50 million in new fee revenue for the trial court trust fund.

- **Transfer and Redirections from other Court Funds.** Part of the solution would include a redirection from other funds, after consultation and negotiation with branch stakeholders. The court's goal is to achieve a consensus on redirections of $50 million.
- **Improved Efficiencies in Court Operations and Changes in Unnecessary Statutory and Reporting Requirements.** The Judicial Branch would identify areas in which courts can become more efficient without threatening the administration of justice and make changes in those areas.
- **Trial Court Fund Balances.** Part of the solution would include the trial courts using $100 million of the fund balances in 2012-13, $75 million in 2013-14, and $50 million in 2014-15.

Court construction funding. The Judicial Branch has two primary court construction funds, the SCFCF, which receives approximately $130 million from fees and penalty assessments to support trial court construction projects, and the Immediate and Critical Needs Account (ICNA), which receives approximately $321 million from various civil and criminal fines and fees to support 41 trial court construction projects that were deemed to be immediate and critical by the Judicial Council. In the current year, the following actions were taken related to these two funds:

- Transferred $310.3 million from the ICNA to the GF.
- Loaned $350 million from the SCFCF to the GF, to be repaid with interest.
- Loaned $90 million from the ICNA to the GF, to be repaid with interest.
- Provided authority to the AOC to allow for redirection of $130 million from the SCFCF and ICNA to offset the reduction to trial court funding.

The AOC submitted a revised court construction funding plan to the Judicial Council in December that results in minimal project delays and the cancelation of only two, one-courtroom projects (Alpine and Sierra). The Legislature should receive a proposal this spring that reflects this funding plan.

Due to delays related to the acquisition of properties, the construction program has been able to proceed with minimal impact to projects. However, in 2012–13 and beyond, the redirections and loans may cause delays to the project schedules

California Court Case Management System (CCMS). As part of an effort to address technology problems facing the many case management systems used by trial courts, the AOC, at the direction of the Judicial Council in 2003, undertook the development of a single court case management system. The most recent version of the statewide case management project, CCMS, covers all court case types. According to a February 2011 report by the State Auditor, AOC records show that in 2015-16, the year in which the AOC estimated at the time of the report that CCMS will be deployed statewide, the full cost of the project is likely to reach nearly $1.9 billion (not including costs that superior courts will incur to implement CCMS). To date, over $500 million has been spent on CCMS. In addition to total cost, other concerns highlighted by the audit include: 1) inadequate planning, 2) failure to adequately structure the development vendor's contract, 3) failure to develop accurate cost estimates, and 4) the AOC's need to gain better support from the superior courts for the project.

To date, the Legislature has not received a comprehensive CCMS deployment and funding plan and concerns have been raised that funding for CCMS should be directed to trial court operations. However, recently the AOC retained a new firm to assist in developing a deployment plan, which will provide baseline deployment cost estimates for three early adopter courts, provide a phase two deployment plan for up to ten additional courts, cost estimates for their deployment, and an analysis of the potential benefits and opportunities of the deployments. The AOC indicates that this report will be made available to the Legislature this spring.

Previous trial court closure. The 2009–10 budget authorized the Judicial Council to provide that the courts be closed for the transaction of judicial business for one day per month. On July 29, 2009, the Judicial Council designated the third Wednesday of the month from September 2009 through June 2010 as a uniform statewide court closure day. The council directed that on that day, all superior courts, Courts of Appeal, and the Supreme Court would be closed.

The impact of court closures varied considerably from court to court. A few courts reported that there was no discernible impact or only a minimal impact. But most courts reported that there was a noticeable impact on court operations and court users from closure of the courts. Workload did not go away simply because the court was closed one day a month. Just as on existing court holidays, that workload shifted to other days. The Legislature may consider asking the AOC to provide greater detail on the impacts of the previous one-day closure and expected impacts of closing trial courts for three days per month.

Proposed legislation would impact trial court funding. AB 1208 (Calderon) addresses judicial branch governance, primarily by reducing the role of the Judicial Council in determining the allocation of funds to trial courts. By doing so, this bill moves away from the recent realignment of trial courts from locals to the state.

The main support for AB 1208 comes from the Alliance of California Judges, which consists of judges who have voiced opposition to many Judicial Council and AOC initiatives and the "erosion" of the power of trial courts in California since the passage of the Lockyer-Isenberg Trial Court Funding Act in 1997.

The Judicial Council opposes AB 1208, arguing that the bill would remove from the Judicial Council its responsibility and authority to allocate funds to trial courts in a manner that supports implementation of statewide policies and initiatives. The council also has expressed concern that AB 1208 removes the council’s role of ensuring the stability of trial court operations and providing management or oversight over trial court budgets and that it is an inappropriate intrusion into the fundamental governance of the judicial branch.

Division of Juvenile Justice Realignment

BACKGROUND:

The Division of Juvenile Justice (DJJ), originally known as the California Youth Authority (CYA), was created by statute in 1941 and began operating in 1943, providing training and parole supervision for juvenile and young adult offenders.

In a reorganization of the California corrections agencies in 2005, the CYA became the DJJ within the Department of Corrections and Rehabilitation. Currently, the DJJ receives its youthful offender population from both juvenile and adult court referrals.

The DJJ carries out its responsibilities through three divisions: the Division of Juvenile Facilities, the Division of Juvenile Programs, and the Division of Juvenile Parole Operations. The Juvenile Parole Board, an administrative body separate from DJJ, determines a youth's parole readiness.

Youths committed directly to the DJJ do not receive determinate sentences. A youth's length of stay is determined by the severity of the committing offense and their progress toward parole readiness; however, the DJJ is authorized to house youths until age 21 or 25, depending upon their commitment offense.

The DJJ also provides housing for youths under the age of 18 who have been sentenced to state prison. Youths sentenced to state prison may remain at DJJ until age 18, or if the youth can complete his or her sentence prior to age 21, the DJJ may house him or her until released to parole.

The vast majority of youthful offenders are now directed to county programs, enabling direct access and closer proximity to their homes, families, social programs and services, and other support systems. Those youths directed to the DJJ have been convicted of the most serious and violent crimes and/or are most in need of the specialized treatment services necessary for their success. DJJ youth represent approximately one percent of the 225,000 youth arrests each year.

GOVERNOR’S PROPOSAL:

The Governor proposes that DJJ will stop intake of new juvenile offenders effective January 1, 2013, eventually transferring the responsibility for managing all youthful offenders to local jurisdictions. The Governor’s proposal includes $10 million in 2011-12 to support local governments in planning for the realignment of the remaining DJJ population. Absent realignment, DJJ’s proposed budget is $199 million for 2012-13.

The Governor has delayed charging counties $125,000 per juvenile offenders committed to DJJ, pursuant to the current-year trigger.

ISSUES TO CONSIDER:

Previous efforts to realign the state's juvenile justice responsibilities to local jurisdictions have been successful. Since reaching a high of 10,122 in 1996, the number of youths committed to the DJJ by juvenile and superior courts has steadily declined. The budget reports that DJJ's average daily population will be 1,149 in 2012-13. This reduction in population has led to the closing of the majority of DJJ facilities. Today the DJJ operates three facilities (two in Stockton and one in Ventura) and one fire camp.

The drastic decline in population began in the mid to late 1990s and continued through the last decade due to the following factors:

- Counties received increased federal funding to build additional treatment facilities.
- *Chapter 6, Statutes of 1996, (SB 681, Hurtt),* enacted changes in fees counties paid to house youths in DJJ facilities based upon the classification of a youths commitment offense.
- *Chapter 175, Statutes of 2007, (SB 81, Committee on Budget and Fiscal Review) and Chapter 257, Statutes of 2007, (AB 191, Committee on Budget),* restricted juvenile court commitments to cases that were violent offenses as specified in Section 707(b) of the Welfare and Institutions Code, or sex offenses as specified in Section 290 of the Penal Code.
- *Chapter 729, Statutes of 2010, (AB 1628, Blumenfield),* transferred youth parole responsibilities to county probation, eliminating DJJ parole by June 30, 2014.

Along with the increased responsibility, the state has provided locals with resources to house and treat juvenile offenders, including the following sources that are all ongoing, except the local jail construction funds:

(dollars in millions)

Source	Amount
Juvenile Justice Crime Prevention Grants	$107.1
Juvenile Probation Funding	151.8
Juvenile Camp Funding	29.4
SB 81/AB 191 and AB 1628 Realignment	104.1
Local Jail Construction	$300

A recent report by the Center on Juvenile and Criminal Justice notes that several counties, such as San Bernardino, Napa, Santa Clara, Alameda, San Francisco and Santa Cruz, have implemented innovative local practices for rehabilitation of serious youth offenders. The report further notes that some of these counties are seeing reductions in recidivism rates. Additionally, according to the California Department of Justice's most recent report on crime statistics, juvenile arrest rates have decreased from 2005-2010.

What is an appropriate level of state juvenile justice responsibility. If the Governor's proposal to realign responsibility for all juvenile offenders in California is adopted, California may be the only state without state sanctions for juvenile offenders. DJJ's current population, although small in numbers, is comprised of our state's highest risk juvenile offender population. Representatives of probation officers have noted that they do not have the capacity to treat many of the youth that are sent to DJJ because of the severity of their treatment need (many have acute mental health or sexual behavioral symptoms) nor do they want to house these youth with the population that is currently kept locally due to management concerns.

On the other hand, some have questioned the state's ability to house and provide adequate services for juvenile offenders. DJJ is currently under a consent decree as a result of the *Farrell v. Cate* lawsuit, which was initiated with a complaint surrounding conditions in the juvenile justice system that was filed in state court in January 2003. Six remedial plans were developed and have guided improvements (a Special Master in the *Farrell* case has filed periodic reports detailing the changes in conditions). However, there is continuing debate as to whether the DJJ can ever reach full *Farrell* compliance.

Counties are currently implementing changes to absorb the impact of the 2011 public safety realignment. Per the 2011 Public Safety Realignment, which requires that certain low-level felony offenders serve their time locally and shifts the majority of the state's parole population to local jurisdictions, counties are currently dealing with a significant increase in public safety responsibilities. Probation departments are in the process of creating and implementing new supervision strategies and adjusting workforces accordingly. Given this huge shift in responsibility that local probation departments are currently dealing with, the Legislature must consider impacts that realigning the state's juvenile population at this time may have on the implementation of the 2011 public safety realignment.

Potential hurdles. Stakeholders and the Administration have acknowledged issues related to realigning DJJ's population, including statutory issues, that remain unresolved. These include; 1) age of jurisdiction, counties can only retain wards up to the age of 21, while DJJ retains wards to the age of 25, 2) court commitment changes, establishing a process for changes in commitment status, 3) the potential increase in Direct Files of juveniles in adult court, and 4) potential sight and sound barriers required for inmates under the age of 18, if they are housed in adult institutions. Until resolution to many of these issues becomes clearer, it may be premature to provide locals with $10 million in planning funding, as the budget proposes.

CDCR Realignment Savings

BACKGROUND:

Last year, Governor Brown signed AB 109 and AB 117 (known as public safety realignment), historic legislation that will enable California to close the revolving door of low-level inmates cycling in and out of state prisons. It is the cornerstone of California's solution for reducing the number of inmates in the state's 33 prison to 137.5 percent of design capacity by June 27, 2013, as ordered by a Three-Judge Court and affirmed by the United States Supreme Court. In a May 23, 2011 decision, the United States Supreme Court affirmed the judgment of a three-judge panel convened pursuant to the Prison Litigation Reform Act of 1995 (18 U. S. C. §3626) ordering California to reduce its prison population to no more than 137.5 percent of its design capacity within two years.

Key Features of Public Safety Realignment

Felon Incarceration	Post-Release Supervision	Parole and PRCS Revocations
Restructured felon penalty by making specified non-violent, non-serious, non-sex offenses subject to local punishment	Created Post Release Community Supervision (PRCS) for certain offenders to be supervised locally upon release from prison	Parole revocation terms are served locally and, by July 1, 2013 both parole and PRCS revocations will be adjudicated by the courts

Under AB 109 and AB 117, all felons convicted of current or prior serious or violent offenses, sex offenses, and sex offenses against children will go to state prison. Additionally, there are nearly 60 additional crimes that are not defined in the Penal Code as serious or violent offenses but remain offenses that would be served in state prison rather than in local custody.

On December 28, 2011, the population of California's 33 prisons was 132,887, or 166.8 percent of design capacity, meeting the first population target of the court order's timeline. Under the Three-Judge Court's prisoner-reduction order, the inmate population in California's 33 prisons must be no more than:

Court Deadlines	Design Capacity Limit	Population Limit	Population Reduction
December 27, 2011	167%	133,000	11,000
June 27, 2012	155%	123,000	10,000
December 27, 2012	147%	117,000	6,000
June 27, 2013	137.5%	110,000	7,000
Two-Year Total			**34,000**

Design capacity is the number of inmates a prison can house based on one inmate per cell, single-level bunks in dormitories, and no beds in places not designed for housing. Current design capacity in CDCR's 33 institutions is 79,650.

GOVERNOR'S PROPOSAL:

The Governor assumes $1.1 billion in savings and reductions of approximately 4,890 positions in CDCR's budget to account for changes in adult inmate and parole populations that are primarily due to public safety realignment. Below is a summary of total CDCR spending followed by a summary of budgeted realignment savings. The total General Fund decrease from 2010-11 to 2012-13 is approximately $817 million.

(dollars in millions) **CDCR Funding**

Funding	2010-11	2011-12	2012-13
General Fund	$9,481.8	$8,980.8	$8,664.8
General Fund, Prop 98	24.5	23.6	21.2
Corrections Training Fund	21.6	22.2	-
Lottery Education Fund	.3	.1	.1
Federal Trust Fund	11.2	28.3	4.6
Inmate Welfare Fund	50.4	65.0	65.3
Special Deposit Fund	.9	2.4	2.3
Reimbursements	106.2	103.3	130.1
Local Safety and Protection Account, Trans Tax Fund	24.4	-	-
Community Incentive Fund	-	-.6	-.6
Total	**$9,721.3**	**$9,252.1**	**$8,887.8**

(dollars in millions) **CDCR Realignment Savings**

Program	2011-12	2012-13
Administration	$-	-$19.2
Institutions	-167.8	-413.0
Parole	-99.3	-220.5
Community Based Programs	-27.1	-138.3
Board of Parole Hearings	-	-16.9
Adult Ed, Voc., Substance Abuse Programs	-6.4	-18.5
Inmate Health Care	-47.2	-111.0
Contract Facilities	-105.5	-138.7
Total	**-$453.3**	**-$1,076.1**

The budget also proposes a reassessment of prison construction needs, recognizing that realignment fundamentally alters the state's future facility needs as funded under AB 900 (Solorio, Statutes of 2007). The primary purpose for the infill program may no longer be present, since the state will no longer operate any non-traditional bed capacity. The budget includes a reduction of $44.5 million to reflect the cancellation of the Estrella infill project. Additionally, the budget reflects that the state is not currently proceeding with the construction and conversion of the DeWitt youth facility to an adult facility. It is anticipated that the state will avoid approximately $250 million in annual debt service costs as a result of the revised construction plan. The Budget also assumes savings of $125 million related to infrastructure projects authorized by AB 900 that are not needed as a result of realignment.

ISSUES TO CONSIDER:

The budget does not include detail on how the $1.1 billion in savings will be operationalized. CDCR has made strides in implementing changes that are reducing costs as realignment impacts the prison population. For instance, CDCR terminated all but one of its contracts with community correctional facilities across the state; terminated or did not renew contracts for inmate services or programs that are not designed for the department's remaining population; and announced its plans to convert Valley State Prison for Women in Chowchilla to a facility that will house low- to medium-security adult male inmates. However, these actions do not address the significant cost reductions that must be achieved within the operations of the department's 33 prisons. During budget hearings, the Legislature should ensure that CDCR presents a plan that details how housing units and staffing will be adjusted in accordance with the proposed budget.

New prison construction will offset savings from realignment. Approximately $6.1 billion was authorized under AB 900 to construct prison beds (infill, re-entry, and health care). The Receiver, appointed to oversee prison medical care, is currently building a 1,722 bed prison in Stockton that will cost just under $1 billion to build and $190-230 million annually to operate once complete. The Receiver has also maintained that the state must keep its commitment to other construction projects.

Although constructing new prison beds would add capacity, it would not help California meet the three-judge panel timeline and. In its last analysis of AB 900, the LAO estimated that the combined costs of infill and re-entry projects would add approximately $1.3 billion annually to CDCR's budget.

Realignment stops growth trend in state corrections. State spending on corrections rose from $604.2 million in 1980-81 to $9.6 billion in 2010-11, a nearly 1,500 percent increase that significantly outpaced the growth of total state General Fund spending during the same period. As a result, state spending on corrections more than tripled as a share of General Fund expenditures, rising from 2.9 percent in 1980-81 to 10.5 percent in 2010-11.

The increase in state corrections spending is related to the significant growth of the inmate and parolee population that occurred in the 1980s and 1990s and to the rising cost of corrections as measured by spending per inmate or parolee. The increase in the offender population is primarily attributable to significant changes in sentencing laws and to more aggressive local law enforcement and prosecution. Higher per inmate or parolee expenditures primarily reflect the dramatic increase in inmate health care spending as well as the rising cost of prison security and adult parole.

Notwithstanding the Supreme Court order to reduce the inmate population due to the recognition of overcrowding as the primary obstacle to a constitutional level of care, realignment is also the only significant policy change that will lead to a substantial reduction in correction's spending at the state level. In times of fiscal austerity, there are very few options to reduce prison spending, which impacts the level of cuts that other state programs must endure. Achieving CDCR's realignment savings is critical, and so too is the cost avoidance realignment will provide for the state going forward, which will allow for greater flexibility in supporting other critical priorities.

Board of State and Community Corrections

BACKGROUND:

Originally, the Board of Corrections (BOC) was established in 1944 as part of the state prison system. Effective July 1, 2005, as part of the corrections agency consolidation, the Corrections Standards Authority (CSA) was created within CDCR by bringing together the BOC and the Correctional Peace Officers Standards and Training (CPOST) commission. The reorganization consolidated the duties and functions of the BOC and CPOST and entrusted the CSA with new responsibilities.

The CSA works in partnership with city and county officials to develop and maintain standards for the construction and operation of local jails and juvenile detention facilities and for the employment and training of local corrections and probation personnel. The CSA also inspects local adult and juvenile detention facilities, administers funding programs for local facility construction, administers grant programs that address crime and delinquency, and conducts special studies relative to the public safety of California's communities.

The CSA currently operates using a four divisional structure:

- **Facilities Standards and Operations Division.** The Facilities Standards and Operations Division works in collaboration with local corrections agencies to maintain and enhance the safety, security, and efficiency of local jails and juvenile detention facilities.
- **Corrections Planning and Programs Division.** The Corrections Planning and Programs Division plans, develops, and administers programs in collaboration with local and State corrections agencies to enhance the effectiveness of correctional systems and improve public safety.
- **Standards and Training for Corrections Division.** The Standards and Training for Corrections Division works in collaboration with State and local corrections and public/private training providers in developing and administering programs designed to ensure the competency of State and local corrections professionals.
- **County Facilities Construction Division.** The County Facilities Construction Division works in collaboration with State and local government agencies in administering funding for county detention facility construction projects, for the purpose of enhancing public safety and conditions of confinement.

Legislation associated with the 2011 Budget Act abolished the CSA and established the new Board of State and Community Corrections (Board) as an independent entity, effective July 1, 2012. The Board will absorb the previous functions of the CSA as well as other public safety programs previously administered by the California Emergency Management Agency (CalEMA). Specific statutory changes include:

- Abolish the CSA within CDCR and established the Board as an independent entity.
- Transfer the powers and duties of the CSA to the Board.
- Transfer certain powers and duties that currently reside with CalEMA to the Board.
- Eliminate the California Council on Criminal Justice and assigned its powers and duties to the Board.
- Reestablish CPOST within CDCR.

The Board will provide statewide leadership, coordination, and technical assistance to promote effective state and local efforts and partnerships in California's adult and juvenile criminal justice system. Particularly important in the next several years will be coordinating with and assisting local governments as they implement the realignment of many adult offenders to local government jurisdictions that began in 2011. The Board will guide statewide public safety policies and ensure that all available resources are maximized and directed to programs that are proven to reduce crime and recidivism among all offenders.

The new Board will be an entity independent from CDCR. The Board will continue to be chaired by the Secretary of CDCR, and its vice-chair will be a local law enforcement representative. The Board will have 12 members, streamlined from both its immediate predecessor (CSA), with 19 members, and its former predecessor (BOC), which had 15 members. Members will reflect state, local, judicial, and public stakeholders.

GOVERNOR'S PROPOSAL:

The Budget proposes $109.2 million ($16.9 million General Fund and $92.2 million other funds) for the state operations and local assistance programs included under the Board. The funding is comprised of resources transferred from the CSA and CalEMA and will allow the Board to operate as an independent entity. The following chart summarizes the proposed funding and program structure of the Board, including resources transferred from CDCR and Cal EMA:

(dollars in millions)

	Funding	Positions
Program 10 - Board Administration and Program Support	$1.99	19.0
Program 15 - Corrections Planning and Grant Programs	$81.26	23.5
Program 20 - Local Facilities Standards and Operations	$3.81	20.0
Program 25 - Standards and Training for Local Corrections	$22.19	13.0
Board Total	**$109.16**	**75.5**
From CDCR	**-$63,191**	**-68.5**
From CalEMA	**-$45,970**	**-8.5**
Net Total of the Establishment of the Board	**$0**	**-1.5**

Beside the core CSA functions, outlined above, the proposal includes $253,000 from CDCR for administrative functions and the transfer of $8.9 million from CDCR to assist counties with the implementation of the 2011 public safety realignment. The Board is to administer these funds, in consultation with the Department of Finance. Of the $8.9 million, $7.9 million is to be distributed to counties for the Community Corrections Partnership to develop realignment implementation plans and the remaining $1 million is to provide state-wide training to counties.

Programs that will transfer from CalEMA include:

- **Edward Byrne Justice Assistance Grant (JAG) Program** - The U.S. Congress established the JAG program in the 2005 Omnibus Appropriations package. California's JAG program recipients include local criminal justice agencies, which utilize the grant to address apprehension, prosecution, adjudication, detention, and rehabilitation of offenders who violate state and local laws. California's JAG program also funds the California Counter Drug Procurement Program.

- **Residential Substance Abuse Treatment (RSAT) Program** - The RSAT Program is designed to assist state and local government agencies in developing and implementing substance abuse treatment programs in correctional and detention facilities and to provide community-based aftercare services for offenders.

- **California Gang Reduction, Intervention, and Prevention (CalGRIP) Initiative** - The CalGRIP Initiative provides Restitution Fund grants to cities using a local collaborative effort for anti-gang activities.

  Lastly, CSA and Cal EMA provided grants directly to local public safety agencies, including: Citizen's Option for Public Safety (COPS); Juvenile Justice Crime Prevention Act Grants; Booking Fees, Small and Rural Sheriffs Grants; Juvenile Probation Funding; California Multi-Jurisdictional Methamphetamine Enforcement Team; California Gang Violence Suppression Program; Multi-Agency Enforcement Consortium; Rural Crime Prevention; Sexual Assault Felony Enforcement; and the High Technology Theft Apprehension and Prosecution Program. Funding for these programs was realigned to locals as part of the 2011 public safety realignment. However, if it is determined that state level administration requirements remain for any of these programs, the Board would fulfill those responsibilities.

ISSUES TO CONSIDER:

The Board will be critical to the implementation and success of the 2011 public safety realignment. One of the key drivers in establishing the Board was the need for a state/local body that could serve as the backbone of California's public safety continuum. To facilitate local success, California needs to strategically coordinate support, foster local leadership, target resources and provide technical assistance. Per statute, the Board will be charged with "providing statewide leadership, coordination, and technical assistance to promote effective state and local efforts and partnerships in California's adult and juvenile criminal justice system, including addressing gang problems. This mission shall reflect the principle of aligning fiscal policy and correctional practices, including, but not limited to prevention, intervention, suppression, supervision, and incapacitation, to promote a justice investment strategy that fits each county and is consistent with the integrated statewide goal of improved public safety through cost-effective, promising, and evidence-based strategies for managing criminal justice populations."

The Board also will have the duty to "collect and maintain available information and data about state and community correctional policies, practices, capacities, and needs, including, but not limited to, prevention, intervention, suppression, supervision, and incapacitation, as they relate to both adult corrections, juvenile justice, and gang problems. The Board shall seek to collect and make publicly available up-to-date data and information reflecting the impact of state and community correctional, juvenile justice, and gang-related policies and practices enacted in the state, as well as information and data concerning promising and evidence-based practices from other jurisdictions."

Within these responsibilities, the Board will play a key role in collecting, maintaining, and reporting data regarding the 2011 public safety realignment. Such data will be critical in understanding how resources should be allocated and how program success is ultimately measured.

It is worth noting that there is significant interest in researching and reporting on aspects of the 2011 public safety realignment from within academic and private foundation communities. One project of note, The Partnership for Community Excellence (The Partnership) established by California Forward, seeks to develop a "hub" to coordinate efforts to assist local governments in implementing public safety realignment. The Partnership notes that the state has not provided any direction or assistance to counties in developing integrated strategies to reduce costs and improve outcomes. This effort highlights the urgency for the Board to take the reins in ensuring that California has an efficient and effective approach to public safety in a time of such momentous change.

Public Employee Retirement

BACKGROUND:

The state offers comprehensive post-employment benefits to its employees, typically comprised of monthly pension payments, as well as health, dental, or other benefits that are funded in part by their former employer. The health, dental, and other benefits are called "other post-employment benefits" (OPEBs). Unlike the pension benefit, the state has not typically “pre-funded” its retiree health liabilities. OPEB costs are instead paid on a “pay-as-you-go” basis and generally there are no investment returns to offset the employer and retiree shares of health costs.

Employee and Employer Pension Contributions

State employees are enrolled in defined benefit pension plans, which provide employees with a specified benefit, generally based on their salary levels near the end of their career, their number of years of service, and the type of job they had while in public employment. The pension benefit is funded from public employer and public employee contributions, as well as investment earnings generated from those contributions. Generally speaking, the state and its employees combined pay pension “normal costs” each year, which are the funds that need to be set aside and invested now to cover all future costs of benefits that employees earn in that year.

As the employer, the state makes annual payments to: (1) pension programs for state and CSU employees, (2) teachers’ pensions, (3) state and CSU retiree health benefit programs, and (4) pension programs for judges. The teachers’ pension program is administered by the California State Teachers’ Retirement System (CalSTRS), and the other three programs are administered by the California Public Employees’ Retirement System (CalPERS). The state also provides funding to UC for retiree health benefit programs.

One clear distinction between CalPERS and CalSTRS is important to understand. CalPERS sets the state employer contribution rate each year, and that rate can rise or fall depending on investment returns and the funded status of the CalPERS plan. CalSTRS, on the other hand, has both the employer and employee rate set in statute. CalSTRS has no legal authority to raise the employer contribution rate in the manner that CalPERS can.

2010 and 2011 Pension Reforms Adopted for State Employees

State employees generally are obligated to contribute only a fixed amount, as a percentage of their pay each month, to these pension plans. In 2010 and 2011, the state collectively bargained and reached agreement with its employees on substantive pension reform. These reforms rolled back pension benefits for new hires to levels in place in the 1970s and, for both current and new employees, increased most employee pension contributions by two to five percent dependent on bargaining unit. In sum and through 2013-14, these increased employee contributions will reduce the state’s required employer pension contribution by $600 million plus General Fund. However, the *net* savings to the state is substantially less.

Employee pension contributions are negotiable; however, as the LAO has reported, there are strict legal protections that limit government's flexibility to impose increased employee contributions. In the case of the 2010 and 2011 pension reforms, negotiations concerning the pension contribution increases also resulted in delayed implementation (by roughly 12 months) of a top step salary increase equivalent to the increased employee pension contribution (two to five percent, dependent on bargaining unit). As noted by the LAO, these salary increases overtime will tend to erode savings from increased employee pension contributions.

Unfunded Liabilities

Unfunded liabilities are the additional amount that would need to be deposited today and invested over time in order to pay all future benefits earned to date by retirement system members. Unfunded liabilities emerge even when the normal costs are paid each year due to: (1) investment returns that fail to meet the pension system's annual target (such as the near-collapse of world financial markets in 2008); (2) changing "experience study," including that employees are retiring earlier and life expectancy is increasing; and/or (3) increases applied to years already worked ("retroactive" increases). Due to the limitations described above on employee pension contributions, the unfunded liabilities are generally the responsibility of the employer. The budget estimates that the state faces unfunded pension obligations of $45.2 billion and unfunded retiree health obligations of $59.9 billion.

LAO Estimates of General Fund Costs for Retirement Programs
(dollars in billions)

	1992-93	1997-98[1]	2002-03	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
CalPERS Retirement Program[2]	$0.48	$1.71	$0.66	$1.86	$1.92	$1.79	$2.00	$2.18	$2.45
CalPERS Retiree Health Program[3]	$0.34	$0.33	$0.65	$1.22	$1.26	$1.30	$1.52	$1.67	$1.87
CalSTRS	$0.69	$0.95	$0.98	$1.62	$1.13	$1.25	$1.26	$1.32	$1.36
Other[4]	$0.03	$0.04	$0.11	$0.15	$0.18	$0.17	$0.16	$0.13	$0.14
Total	**$1.54**	**$3.03**	**$2.40**	**$4.85**	**$4.49**	**$4.51**	**$4.94**	**$5.31**	**$5.82**
Retirement Costs as % of GF	**3.8%**	**5.7%**	**3.1%**	**4.7%**	**4.9%**	**5.2%**	**5.4%**	**6.1%**	**6.3%**

[1]Amount for 1997-98 includes a $1 billion plus state payment related to a major court case involving CalPERS.
[2]CalPERS retirement program costs include state General Fund contributions to CalPERS pensions for state employees, judges, and CSU employees.
[3]CalPERS retiree health program cost listed includes LAO rough estimate of implicit subsidy for retiree health benefits paid as part of state contribution to employees health care costs.
[4]Other includes rough estimate of costs in UC and CSU base budgets for annuitant health and/or dental costs and does not include any amounts for UCRP pension costs.

GOVERNOR'S PROPOSAL:

12-Point Pension Reform Plan. In October 2011, the Governor unveiled a 12-point pension reform plan to put the state on a more sustainable path to providing public retirement benefits. It includes provisions for equal sharing of pension normal costs between employers and employees; places new employees in an as yet undefined "hybrid" risk sharing pension plan; increases retirement ages for new employees; requires three-year final compensation calculations for new employees; calculates benefits based on regular, recurring pay; limits post-retirement employment; requires felons to forfeit their pension benefits; prohibits retroactive pension benefits; prohibits pension holidays; prohibits purchases of air time; changes the makeup of the CalPERS Board of Administration; and, requires new state employees to wait longer to vest for retiree health benefits and bear a larger percentage of the cost attributed to those benefits.

When fully implemented, the Administration estimates that the Governor's 12-point plan will cut roughly in half the cost to taxpayers for providing pension benefits to state employees and will also dramatically reduce the risk for future pension debts. However, at this time no hard data or plan specifics have been offered to assist in substantiating those estimates. The Governor's proposal is currently pending before a legislative Conference Committee on Public Employee Pensions which was convened in fall 2011. The Conference Committee met again on January 25, 2012, and continues its work on pension reform, including consideration of the Governor's proposal as well as numerous other legislative reform proposals.

Budget Proposals. The budget includes $2.4 billion General Fund for the CalPERS retirement program, $1.4 billion General Fund for CalSTRS, and $1.8 billion General Fund for the CalPERS retiree health program.

As part of the Administration's long-term plan for UC and CSU, which is discussed in detail in the higher education section of this report, the budget shifts the following retirement and retired annuitant benefit costs, which are currently budgeted and adjusted annually separately, into UC and CSU's base budgets. The budget states that there will be no further adjustments going forward and instead UC and CSU will factor these costs into their overall fiscal outlook and decision making process:

- $90 million increase for UC base operating costs, which the Administration indicates can be used to address costs related to retirement program contributions.
- $5.2 million increase for UC retired annuitant benefits.
- Decreases CSU's employer contribution to CalPERS by $38.5 million due to lower employer contribution rates. CSU's base budget includes a total of $404 million for the required CalPERS employer contribution.
- $1.1 million increase for CSU retired annuitant benefits.

ISSUES TO CONSIDER:

State Budgetary Savings from Pension Reform Reduce Costs Long-Term. As noted above, in 2010 and 2011, the state collectively bargained and enacted substantive pension reform which, among other things, increased employee contributions (and reduced employer contributions by a like amount). Most state employees are now contributing half, or more, of the annual normal cost of their pension, which is the first point in the Governor's 12-point plan. The LAO has reported that it is unlikely that the Governor's plan would produce much *short-term* budgetary savings for state government; rather, the changes would produce substantial *long-term* savings, potentially in the billions of dollars per year, by reducing the state's vulnerability to increased costs from unfunded liabilities. These savings will grow incrementally over the coming decades as new employees are hired and eventually retire under the lower-tier benefit structure.

State/Local Relationship in the Pension Reform Arena. Under current law, cities, counties, and special districts have significant authority and autonomy to collectively bargain retirement benefits. The Governor's proposal, intended to apply statewide to all public employees, would impose significant limits on local retirement plan components and the division of pension costs between employees and employers. In considering these impacts, the LAO has raised several key questions for the Legislature to consider regarding the conflicts between allowing for local control, the long-term consequences and expense of overly generous pension promises made at the local level, and the ratcheting up of benefits that occurs as local employers compete in certain areas for employees.

What about CalSTRS? As of June 2010, and according to CalSTRS actuaries, CalSTRS' unfunded liability totaled $56 billion (this figure will be updated when the CalSTRS Board adopts the June 30, 2011, valuation in April 2012). This liability is not reflected in the budget estimate of total unfunded pension liabilities of $45.2 billion. As previously noted, unlike CalPERS, employer and employee contributions to CalSTRS are fixed in the Education Code. The contribution levels apply on a generally equal basis to all public school and community college districts and are generally not determined through collective bargaining. While statutory contribution levels cover the normal cost of the plan, the economic meltdown in 2008/2009 left CalSTRS with a significant unfunded liability. Currently, there are no plans in place for any entity to pay for the unfunded liability and ensure CalSTRS' future financial stability. The LAO has noted that the Governor's 12-point plan may reduce costs for future teachers enrolled in CalSTRS but it does not appear to include anything to address the liabilities already accrued, but not funded, for current and past employees. The LAO has reported that addressing the CalSTRS unfunded liability is one of the more difficult long-term financial challenges facing the state.

UC and the University of California Retirement System (UCRP). From 1990 to 2010, UC and its employees enjoyed a two-decade pension funding holiday due to: (1) substantial overfunding of UCRP during the 1980s by the state and UC (and its employees) and (2) very strong investment returns for UCRP during the 1980s and 1990s. The state also benefited from the holiday, since it had contributed to UCRP in prior decades and used the elimination of contributions as a budget solution during the fiscal crisis of the early 1990s. During the contribution holiday, UC continued to add employees and provide additional service credit to existing employees – making it impossible for the holiday to continue forever. The investment market downturn of 2008 caused the already dwindling surplus to fade away and UCRP now has an unfunded liability. In the past several years, UC has reinstituted employee and employer contributions and repeatedly sought additional state funding so it can cover normal costs and retire unfunded liabilities over the next several decades. To date, and despite UC's requests, the Legislature has chosen not to provide additional funding to UC for this purpose. UC projects that total state costs would peak at around $400 million plus.

The LAO has highlighted that these pension costs are real obligations that need to be paid, and it is reasonable for the state to cover the retirement costs of UC's state-funded employees, just as it does for other agencies. One over-arching challenge is that it is not clear what the "state share" should be given that UC also has non-state funded employees (such as through federal funds or patient revenues at the academic medical centers). There are also questions about what legal obligations the Legislature could incur by restarting contributions. Therefore, the LAO has advised that the Legislature proceed with caution and not simply pay whatever bill UC presents, given that UC (rather than the state) controls its pension costs and sets benefits levels for its employees; i.e., the state may choose to re-start state contributions to UC under the right conditions.

As discussed in greater detail in the higher education section of this report, the budget includes a $90 million base budget augmentation which the Administration indicates "can be used to address costs related to retirement program contributions." That these funds are not directly tied to retirement program contributions is indicative of issues identified above by the LAO. In considering the Administration's approach, the Legislature may want to clarify how any such augmentation could be construed. For example, under one view, the $90 million is a budget backfill for internal shifts and/or reductions that have already been implemented in light of the fact that UC restarted employer contributions to UCRP several years ago. In the alternative, the $90 million could also be viewed as representing new state costs (in 2012-13).

CSU Retirement Costs. As discussed in greater detail in the higher education section of this report, the budget proposes to adjust CSU's budget one last time for retirement costs, including its required employer contribution to CalPERS and for retired annuitant health benefits. These costs, and any future adjustments, would then be covered from within CSU's base budget; i.e., the state General Fund would no longer account for the annual adjustment, be it a cost increase or a cost decrease. Per the "funding agreement" and contingent on CSU's performance on specific metrics, CSU's base budget could grow but these retirement costs would be covered from within the base budget.

By bringing these costs onto CSU's base budget, the Administration intends for CSU to consider them in its budget and fiscal outlook; in essence, the Administration is trying to incent CSU to operate efficiently and effectively and balance all of its needs within its budget. From CSU's perspective, this approach adds costs that have been historically covered by the state budget and, further, is not completely within the employer's control. For instance, the CalPERS Board sets the employer contribution rate. But this is not unique to CSU as an employer; this also applies to the state as well as every other public employer who contracts with CalPERS. Employee pension contributions are negotiable; however, as the LAO has reported, there are strict legal protections that limit government's flexibility to impose increased employee contributions. Rather, for many current employees such contribution increases would be implemented only through negotiations, and in any event, would result in many employers providing comparable offsetting advantages, such as increasing pay or other compensation, to offset the financial effect of the higher pension contributions. This would tend to erode any savings from increased employee pension contributions.

Given that the state does not collectively bargain with CSU employees (note, the 2010 reforms described above pertaining to reduced pension benefits for new hires effective January 15, 2011, includes new CSU hires as of that date), the Administration has identified a valid issue with CSU and its management of its retirement costs – whether the state General Fund should continue to cover changes in CSU's retirement-related costs beyond the amount provided in the base budget. However, if the budget proposal is not the "right" approach, the Legislature may wish to consider other possible approaches and what changes might be needed to implement those other approaches.

Unemployment Insurance

BACKGROUND:

The Unemployment Insurance (UI) program is a federal-state program, authorized in federal law but with broad discretion for states to set benefit and employer contribution levels. The UI program provides weekly payments to eligible workers who lose their jobs through no fault of their own. Benefits range from $40 to $450 per week, depending on earnings in a 12-month base period. The program is financed by unemployment tax contributions paid by employers, based on the number of employees, on the first $7,000 of taxable wages paid to each employee. The contribution schedule is comprised of seven schedules, ranging from AA to F, with a range of 0.1 percent (the lowest rate on Schedule AA) to 6.2 percent (the maximum rate on Schedule F). Current law also includes a provision to add a 15 percent emergency solvency surcharge when the UI fund reserve is low (Schedule F+). California employers have been on this emergency F+ schedule since calendar year 2004.

The UI Trust Fund (UI fund) became insolvent in January 2009 and ended that year with a shortfall of $6.2 billion. The contributing factors to the insolvency of the UI fund are: (1) significant statutory increases to the UI benefit level that began in 2002 – these legislative changes increased the maximum weekly benefit amount from $230 per week to $450 per week; (2) no change in the UI financing structure despite significant increases to UI benefits – for example, the taxable wage ceiling has remained at the federal minimum level of $7,000 since 1983; (3) the inability of the fund to build a healthy reserve in the last decade – the Employment Development Department indicates that the existing UI financing system can be sustained in the long run only if the state unemployment rate averaged around four percent over time; and (4) the current economy which resulted in increased UI benefit payments and decreased revenues.

With the UI fund insolvent, the state began borrowing funds from the Federal Unemployment Account in order to continue paying UI benefits to qualifying claimants without interruption. The UI fund deficit was $9.8 billion at the end of 2011 and is expected to increase to $11.7 billion at the end of 2012. Generally, loans lasting more than one year require interest payments; the federal American Recovery and Reinvestment Act (ARRA) of 2009 provided temporary relief to states from making interest payments on UI loans through December 31, 2010. With the expiration of the ARRA provisions, interest of $303.5 million was paid in September 2011 and the budget includes an interest payment due in September 2012 totaling $417 million (estimated). Interest will continue to accrue and be payable annually until the principal on the federal UI loan is repaid. Federal law requires that the interest payment come from state funds.

The September 2011 interest payment of $303.5 million was made by borrowing funds from the Unemployment Compensation Disability Fund (DI Fund). Under current law, those funds are to be repaid from the General Fund to the DI Fund by 2016.

Federal law also includes provisions to ensure that a state does not continue to incur loans over an extended period. Specifically, if a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid before November of the second year or employers face higher federal UI taxes. Due to California carrying an outstanding loan balance for two consecutive years, the Federal Unemployment Tax (FUTA) credit will decrease from 5.4 percent to 5.1 percent on January 1, 2012. This will result in employers paying an additional $21 per employee per year; the aggregate increase in employer costs in 2012 is $300 million (estimated). These additional federal taxes pay down the principal on the federal loan. The FUTA credits will continue to decrease by 0.3 percent each year until the federal loans are paid in full (and the UI fund is solvent). In 2013, the increased cost is $50 per employee (estimated); the aggregate increase in employer costs in 2013 is $606 million (estimated).

GOVERNOR'S PROPOSAL:

Similar to the approach taken in 2011-12, the budget loans $417 million from the DI Fund to the General Fund to pay the September 2012 interest payment due to the federal government. The budget does not include a payment from the General Fund to the DI Fund to begin repayment of the 2011 loan from the DI Fund. Rather, the budget proposes to repay the $303.5 million due to the DI Fund by increasing the amount of the employer surcharge discussed below.

To fund future interest payments for funds borrowed from the federal government to pay UI benefits, and to repay the funds borrowed from the DI Fund in both 2011 and 2012, the budget increases, through trailer bill language that requires a 2/3rds vote (effective January 1, 2013), the employer surcharge payable to the Employment Training Fund by a total of $472.6 million ($39 per employee). The surcharge would be eliminated once the UI debt to the federal government is fully paid back and there is no longer a need to pay interest payments. Until that point is reached, the Administration indicates that this proposal would increase taxes on nearly every California employer by between $40 and $61 per employee per year, fluctuating each year to fully fund the interest costs due to the federal government.

In conjunction with the employer surcharge, the budget increases the minimum monetary eligibility to qualify for UI benefits to account for increases in employee wages that have occurred since the requirements were last adjusted in 1992. Under current law, to meet monetary eligibility requirements, a claimant must have earned: (1) at least $900 in a single quarter and total base period earnings of $1,125 or (2) at least $1,300 in any one quarter in the base period. The budget increases the minimum eligibility to: (1) $1,920 in the highest quarter and total base period earnings of $2,400 or (2) at least $3,200 in any one quarter in the base period. With these changes, approximately 40,000 individuals would no longer be eligible for UI benefits, saving $30 million per year.

ISSUES TO CONSIDER:

The Current State of the Economy. In developing its proposal, the Administration indicates that it took into consideration the current state of the economy and its recovery, and the potential cost impacts that an overall UI solvency proposal would present to employers (and the economy). By acting now to comprehensively address UI fund insolvency, the Legislature could stop the growth of the UI fund deficit and reduce associated state interest costs. On the other hand, such actions have the disadvantage of increasing employer costs and/or decreasing aid to unemployed workers during a difficult economic time for the state. However, continuing with a large outstanding federal loan will also increase costs to employers through reduced federal tax credits.

The Budget Does Not Contain a Comprehensive Solution to the Issue of UI Trust Fund Insolvency. Funds raised by the Governor's proposed employer surcharge would be limited to repayment of interest on the federal loans to keep the UI fund solvent. While this approach protects the General Fund from bearing these costs and prevents the state from accruing additional internal debt to make the federal interest payments, the proposal does little to address either the insolvency of the UI fund or the long-term structural imbalance between UI fund revenues and expenditures. Continuing to carry a balance on the loan to the UI fund will result in automatic and gradually increasing federal employer UI-related tax increases which pay down the principal on the federal loan to the state's UI fund. The potential drawbacks of the budget proposal include that it: (1) takes longer to repay the federal loan (resulting in higher interest costs) than otherwise would be the case; (2) concentrates the impact of repaying the federal loan almost entirely on employers; and (3) does not comprehensively address the structural imbalance in the UI fund. In its initial review of the Governor's budget, the LAO recommended that the Legislature consider a more comprehensive plan, one that makes more significant increases to employer taxes and/or decreases to benefit payments, to address the structural imbalance in the UI program and allow for more timely repayment of the federal loan.

The Underlying Financial Structure of the UI Trust Fund is Key. One of the contributing factors to the current UI fund insolvency is the inability of the fund to build a healthy reserve in the last decade. In prior decades, the fund balance built sufficient reserves during times of economic expansion so that the lowest tax rate schedule could be used before entering a period of economic contraction. This pattern ended in the 1990s. In the years leading up to the recession of the early 2000s, the UI fund was unable to build a high enough reserve to safely cover the next recession. Employers were still on schedule C in the late 1990s and in the early 2000s, as the state entered into a brief recession. Soon after, benefits levels were increased with no changes to the revenue structure. As the state entered this most recent recession in 2008, in which the unemployment rate hit record highs, the fund had an insufficient reserve, even though employers had been on the highest state tax rate schedule F+ since 2004. The EDD estimates that even as more firms pay higher rates under the F+ schedule, the current system can only generate about $6 billion in annual revenues. The situation in the late 1990s and early 2000s suggests that the UI financing system was not robust enough to build sufficient reserves. According to EDD estimates, the existing UI financing system can be sustained in the long run only if the state unemployment rate averaged around 4 percent over time. Such low rates of unemployment have been historically rare in California.

Potential Solutions to UI Trust Fund Insolvency. As the LAO noted in its October 2010 report entitled, *California's Other Budget Deficit: The Unemployment Insurance Fund Insolvency*, the Legislature essentially has three main choices for returning the UI fund to solvency – reducing benefit payments, increasing employer tax contributions, or adopting some combination of the two. To assist the Legislature, the LAO examined multiple scenarios for achieving solvency and found that: (1) decreasing UI benefits alone cannot address the fund insolvency in the near future; (2) options involving UI tax increases could quickly improve the fund condition; (3) employer tax increases could hurt California's competitiveness; and (4) the UI financing structure is not sufficiently robust.

Further complicating consideration of these issues, the Administration points to the fact that there are 28 other states that face a similar situation with their UI Fund, indicative that this is a national issue which may be addressed on the federal level. In its July 2011 report entitled, *Managing California's Insolvency: The Impact of Federal Proposals on Unemployment Insurance*, the LAO noted that three federal proposals had been introduced to address the insolvency issue and determined that all three would improve the solvency of California's UI fund. However, it remains unclear whether any federal reforms will be enacted. This uncertainty complicates the Legislature's decision as to how it should address the insolvency of its UI fund. The LAO recommended that regardless of whether Congress acts to address the UI insolvency problems faced by California and other states, the Legislature should ensure implementation of a long-term solvency plan by 2014. If federal reforms are enacted, it is likely that no additional action by the Legislature will be necessary to ensure long-term solvency. However, if no federal reforms are enacted, it will be critically important for the Legislature to adopt its own long-term solvency plan.

APPENDIX

TIMELINE FOR THE 2012-13 BUDGET BILL

Tuesday	January 5	Governor submits State Budget to the Legislature.
Tuesday	January 6	Committee releases *Quick Summary of Governor's Proposed Budget.*
Wednesday	January 11	Legislative Analyst submits *Overview of the Governor's Budget.*
Thursday	January 19	Committee conducts overview hearing of the budget. Department of Finance presents budget and the Legislative Analyst provides initial review.
Monday	February 6	Committee releases *Overview of the 2012-13 Governor's Budget.*
Thursday	February 16	Full Budget Committee holds oversight hearing on Governor's Education Reform Proposals.
Thursday	February 23	Full Budget Committee holds oversight hearing on Governor's Proposals on Long-Term Care and Medi-Cal Managed Care.
Thursday	March 1	Full Budget Committee holds oversight hearing on Governor's CalWORKs and Child Care Proposals and Program Redesign.
Monday	March 5	Subcommittee hearings may begin.
Thursday	March 29	Spring Recess begins.
Tuesday	April 2	Department of Finance submit Finance Letters.
Monday	April 9	Legislature reconvenes from Spring Recess.
Tuesday	May 1	Department of Finance submits final capital outlay revisions.
Monday	May 14	Governor delivers May Revision to the Legislature.
Friday	June 15	Legislature must pass budget to meet constitutional deadline for passage of the budget.

STAFF ASSIGNMENTS

CORRECTIONS/PUBLIC SAFETY	Joe Stephenshaw
EDUCATION	
K-12	Kim Connor
Higher Education	Kris Kuzmich
Child Care	Keely Bosler
ENERGY	Catherine Freeman
ENVIRONMENTAL PROTECTION	Catherine Freeman
JUDICIARY	Joe Stephenshaw
LABOR & EMPLOYEE COMPENSATION	Kris Kuzmich
LOCAL GOVERNMENT	Brian Annis
HEALTH	Michelle Baass
HUMAN SERVICES	Jennifer Troia
RESOURCES	Catherine Freeman
REVENUES	Keely Bosler
STATE ADMINISTRATION	Brady Van Engelen Brian Annis
TRANSPORTATION	Brian Annis
VETERANS AFFAIRS	Brady Van Engelen
COMMITTEE ASSISTANT	Glenda Higgins
RECEPTIONIST	Mary Teabo

CALIFORNIA STATE BUDGET HISTORY

Fiscal Year	Bill and Chapter No.	Date Passed and Chaptered		Total Budget ($ Billions)
1965-66	AB 500/757	6-18	6-30	4.0
1966-67[a]	SB 1XX/2	6-30	6-30	4.7
1967-68	AB 303/500	6-29	6-30	5.0
1968-69	SB 240/430	6-28	6-29	5.7
1969-70	SB 255/355	7-3	7-3	6.3
1970-71	AB 525/303	7-4	7-4	6.6
1971-72[b]	SB 207/266	7-2	7-3	6.7
1972-73[c]	SB 50/156	6-15	6-22	7.4
1973-74	AB 110/129	6-28	6-30	9.3
1974-75	SB 1525/375	6-28	6-30	10.3
1975-76	SB 199/176	6-26	7-1	11.5
1976-77	SB 1410/320	7-1	7-2	12.6
1977-78	AB 184/219	6-24	6-30	14.0
1978-79	AB 2190/359	7-5	7-6	18.8
1979-80	SB 190/259	7-12	7-13	21.5
1980-81	AB 2020/510	7-16	7-16	24.5
1981-82c	SB 110/99	6-15	6-28	25.0
1982-83	AB 21/326	6-30	6-30	25.3
1983-84	SB 123/324	7-19	7-21	26.8
1984-85c	AB 2313/258	6-15	6-27	31.0
1985-86c	SB 150/111	6-13	6-28	35.0
1986-87c	AB 3217/186	6-12	6-25	38.1
1987-88	SB 152/135	7-1	7-7	40.5
1988-89	AB 224/313	6-30	7-8	44.6
1989-90	SB 165/93	6-29	7-7	48.6
1990-91	SB 899/467	7-28	7-31	51.4
1991-92	AB 222/118	6-20/7-4	7-16	55.7
1992-93	AB 979/587	8-29	9-2	57.0
1993-94	SB 80/55	6-22	6-30	52.1
1994-95	SB 2120/139	7-4	7-8	57.5
1995-96	AB 903/303	8-2	8-3	56.8
1996-97	SB 1393/162	7-8	7-15	61.5
1997-98	AB 107/282	8-11	8/18	67.2
1998-99	AB 1656/324	8-11	8-21	71.9
1999-00	SB 160/50	6/16	6/29	81.3
2000-01	AB 1740/52	6/22	6/30	99.4
2001-02	SB 739/106	7/21	7/26	103.3
2002-03	AB 425/379	9/1	9/5	98.9
2003-04	AB 1765/157	7/29	8/2	98.9
2004-05	SB 1113/208	7/29	7/31	105.3
2005-06	SB 77/38	7/7	7/11	117.3
2006-07	AB 1801/47	6/27	6/30	131.4
2007-08	SB 77/171	8/21	8/24	146.5
2008-09	AB 1781/268 & AB 88/269	9/16	9/23	144.5
2009-10	SBx3 1/Ch 1 & ABx4 1/Ch 1	2/20	7/28	119.2
2010-11	SB 870/Ch 712	10/7	10/8	125.3
2011-12	SB 87 /Ch 33	6/28	6/30	129.5

[a] *1966 Second Extraordinary Session.*
[b] *First year budget was to be enacted by June 15.*
[c] *June 15 constitutional deadline met (5).*

Governor's List of Mandates Proposed for Repeal (non-education)

#	Title of Mandate	Department of Finance Description and Rational for Action	Governor's Proposal	Year First Suspended (Approximate)
1	Adult Felony Restitution	The mandate requires local probation officers to include a determination as to probation fines and restitution to the victim in a report to the court. This mandate will be repealed because the inclusion of this data to the courts has been in place for many years and is likely now a best practice. Additionally, what is provided to the courts in probation reports regarding restitution should be a local decision rather than a statutory requirement.	Repeal	1990
2	AIDS/Search Warrant	The mandate requires crime victims be notified of various rights associated with requesting, preparation of, and service of a search warrant for HIV testing of the victim and the assailant, as well as the administration of the test, confidentiality of test results, and receipt of professional counseling. This mandate will be repealed because the activities should now be standard operating procedures for District Attorneys and local health officers. Additionally, other statutes require similar information.	Repeal	2009
3	Animal Adoption	The mandate increased the holding period for stray and abandoned dogs, cats, and other specified animals from three days to four to six days. This mandate will be repealed because it is more appropriate to allow local governments to determine how long to care for certain animals.	Repeal	2009

Governor's List of Mandates Proposed for Repeal (non-education)

4	Crime Victims' Domestic Violence Incident Reports II	The mandate requires local law enforcement agencies to take a weapon discovered at a domestic violence scene. This mandate will be made permissive because this should be standard operating procedure for local law enforcement.	Permissive	2010
5	Domestic Violence Information	The mandate requires local law enforcement agencies to develop and implement written policies, standards, and incident report forms for officers' response to domestic violence calls as well as maintaining records of all protection orders associated with those incidents. This mandate will be repealed because the activities should now be standard operating procedure for local law enforcement.	Repeal	1990
6	Elder Abuse, Law Enforcement Training	The mandate requires local law enforcement officers to complete training on elder and dependent adult abuse that is certified by the Commission on Peace Officers Standards and Training (POST). This mandate will be repealed because this should now be best practices for local law enforcement.	Repeal	2003
7	Extended Commitment, Youth Authority	The mandate requires prosecuting attorneys to extend the commitment of specified youths. This mandate will be repealed because sentencing laws already allow flexibility for district attorneys to seek varying durations of commitment, on a case-by-case basis, and this should be a local decision.	Repeal	2003
8	Filipino Employee Surveys	The mandate requires local agencies to categorize Filipino employees as a separate ethnic calculation in employee ethnicity survey and tabulations. This mandate will be repealed because other laws require similar	Repeal	1990

Governor's List of Mandates Proposed for Repeal (non-education)

		information.		
9	Firearm Hearings for Discharged Inpatients	The mandate requires the district attorney to represent the people of the state of California in civil proceedings. This mandate will be repealed because the Department of Justice should be able to represent the people in these infrequent circumstances.	Repeal	2009
10	Grand Jury Proceedings	The mandate requires local agencies to perform certain activities for grand jury proceedings such as developing a training program for grand jurors, and providing meeting rooms and reports. This mandate will be repealed. Guidelines and best practices could be provided to assist in the operation of grand jury proceedings as opposed to mandating specific methods.	Repeal	2005
11	Law Enforcement Sexual Harassment Training	The mandate requires local law enforcement agencies to follow sexual harassment complaint guidelines developed by the Commission on Peace Officer Standards and Training (POST) and for peace officers to receive sexual harassment training. This mandate will be repealed because it should be local law enforcement discretion to avail itself of the POST-certified course.	Repeal	2003
12	Missing Persons Report	The mandate requires local law enforcement agencies to take a report of a missing person, and, depending upon certain criteria, to submit the report to the Department of Justice. This mandate will be repealed because this should be standard operating procedure by local law enforcement. Guidelines could be provided.	Repeal	2005

Governor's List of Mandates Proposed for Repeal (non-education)

13	Personal Safety Alarm Devices	The mandate requires local fire departments to have a personal alarm device for each of its firefighters to be used in conjunction with a self-contained breathing apparatus. This mandate will be repealed because this should now be standard operating procedure.	Repeal	1990
14	Photographic Record of Evidence	The mandate requires local agencies to provide exhibits, such as photographs, in criminal trials in lieu of actual items that are of a toxic nature and pose a health hazard to humans. This mandate will be repealed as this should be standard operating procedure for local agencies for health and safety reasons. In addition, there should be cost savings as a result of keeping a copy of evidence as opposed to paying for storage.	Repeal	2009
15	Pocket Masks	The mandate requires every law enforcement agency employing peace officers to provide them with a portable manual mask and airway assembly designed to prevent the spread of communicable diseases when applying CPR. This mandate will be repealed as this should now be standard operating procedure.	Repeal	1990
16	Prisoner Parental Rights	The mandate requires local governments to transport prisoners to and from the court and house them as necessary, so they can attend proceedings to terminate their parental rights or establish legal guardianship over their children. Locals are responsible for ensuring prisoner access to court proceedings affecting their parental rights. Most of these offenders now serve their sentences locally, making the cost of transportation and housing minimal.	Repeal	2005

Governor's List of Mandates Proposed for Repeal (non-education)

17	Stolen Vehicle Notification	The mandate requires local law enforcement agencies that recover stolen vehicles to notify the individual who reported the vehicle stolen within 48 hours. This mandate will be repealed as this is a responsibility of local law enforcement and timing should be locally-determined.	Repeal	2009
18	Victims' Statements-Minors	The mandate requires a probation officer to obtain a statement from a victim of a crime committed by a minor, that would be a felony if committed by an adult, and to include that statement in the social study submitted to the court. This mandate will be repealed because this is a basic responsibility of law enforcement.	Repeal	1990
19	Crime Statistics Reports for the Department of Justice Amended	The mandate requires local law enforcement agencies to report specified demographic data on victims and suspects of specified crimes to the Department of Justice. This mandate will be made permissive. This information is used in part for the receipt and provision of federal funds to local entities.	Permissive	2012
20	Airport Land Use Commission/Plans	The mandate requires counties with an airport to establish an airport land use commission or designate alternative procedures to accomplish airport land use planning. This mandate will be repealed because this should be determined by local government priorities.	Repeal	2005
21	False Reports of Police Misconduct	The mandate requires law enforcement agencies that receive an allegation of misconduct against a peace officer to have the complainant read and sign an advisory. This mandate will be repealed because this should be standard operating procedure.	Repeal	2009

Governor's List of Mandates Proposed for Repeal (non-education)

22	Deaf Teletype Equipment	The mandate requires counties to provide 911 deaf teletype equipment at central locations throughout the state. This mandate will be repealed because this should be standard operating procedure.	Repeal	1990
23	SIDS Training for Firefighters	The mandate requires local agencies to provide training and instruction to new and veteran firefighters on Sudden Infant Death Syndrome. This mandate will be repealed because this should be standard operating procedure.	Repeal	2003
24	Local Coastal Plans	The mandate requires local agencies that have land within the coastal zone to prepare a local coastal plan that outlines how the 1976 California Coastal Act will be implemented on a local level. This mandate will be repealed because most local agencies have already prepared plans or must prepare a plan in order to issue coastal development permits.	Repeal	1993
25	Conservatorship: Developmentally Disabled Adults	The mandate requires legal counsel be provided to a developmentally-disabled person in certain conservatorship proceedings and specifies the requirements for conservatorships for an individual that is a patient of or on leave of absence from an institution under the Department of Mental Health or Department of Developmental Services. This mandate will be repealed as this should be standard operating procedure.	Repeal	2009

Governor's List of Mandates Proposed for Repeal (non-education)

26	Mentally Retarded Defendants Representation	The mandate requires the district attorney, probation department and regional center for the developmentally disabled to submit a report to the court which would contain a recommendation on the defendant's avoidance of jail and would provide procedures for having specified charges dropped. This mandate will be repealed because it should be a local discretion to determine whether to divert from incarceration.	Repeal	2009
27	Not Guilty by Reason of Insanity	The mandate requires the district attorney to petition a court to extend commitments in mental health hospitals for individuals who have been found not guilty by reason of insanity and committed to specified state institutions. This mandate will be repealed. The Department of State Hospitals is drafting statute to provide standards for committing individuals as Not Guilty By Reason of Insanity.	Repeal	2009
28	Perinatal Services	The mandate requires local health county practitioners to: establish protocols between county health departments, county welfare departments, and all hospitals in the county, regarding a substance-exposed infant to a county welfare department, and to submit an assessment of needs. This mandate will be repealed because counties have broad authority to establish protocols for the provision of services to substance-exposed infants.	Repeal	2009
29	SIDS Autopsies	The mandate requires counties to conduct autopsies on infants who die suddenly and unexpectedly and to use Department of Health Services' protocols and forms related to Sudden Infant Death Syndrome. This mandate will be repealed	Repeal	2003

		because this should be standard operating procedure.		
30	SIDS Contacts by Local Health Officers	The mandate requires local health officers to provide information on counseling and support services to the guardian of an infant who has died from Sudden Infant Death Syndrome. This mandate will be repealed because this should be standard operating procedure.	Repeal	2003
31	Inmate AIDS Testing	The mandate requires local agencies to test specified inmates and report the incidents where the individuals came into contact with the Human Immunodeficiency Virus (HIV). This mandate will be made permissive and provided at local discretion.	Permissive	2003
32	Judiciary Proceedings	The mandate requires the county to investigate, prepare for, and conduct a proceeding for commitment, placement, or release of a mentally retarded person who is a danger to himself or others and resides in a state hospital's treatment program. This mandate will be repealed because the courts have the authority to commit mentally retarded individuals that are a danger to themselves or others to a state developmental center.	Repeal	2009

Solutions for 2012-13 Governor's Budget

(Dollars in Millions)

	Org	Description	2011-12 or prior	2012-13	2-year total
Expenditure Reductions					
1	0820	**Eliminate General Fund support of Armed Prohibited Persons Program and replace with DROS**	0.0	4.9	4.9
2	1760	**Delay State Capitol Repairs**	0.0	2.7	2.7
3	3640/ 3760/3860	**Habitat Conservation Fund Transfer: Shift to Proposition 1E**	0.0	18.5	18.5
4	4140	**Shift Song-Brown Program to CA Health Data and Planning Fund**	0.0	5.0	5.0
5	4260	**Medi-Cal: Integrate Care for Dual Eligible Beneficiaries**	0.0	682.4	682.4
6	4260/4280	**Reduce Healthy Families Rates**	0.0	64.4	64.4
7	4260	**Medi-Cal: Program Delivery Efficiencies**	0.0	75.0	75.0
8	4260	**Medi-Cal: Other Reduction Options**	0.0	84.9	84.9
9	4265	**AIDS Drug Assistance Share of Cost**	- 0.0	14.5	14.5
10	4280	**Excess Children's Health and Human Services Fund (MCO)**	10.6	-10.6	0.0

Solutions for 2012-13 Governor's Budget

(Dollars in Millions)

	Org	Description	2011-12 or prior	2012-13	2-year total
11	4440	**Incompetent to Stand Trial (IST) Treatment**	0.0	3.0	3.0
12	5180, 7980	**CalWORKs Restructuring/Reform**	-38.6	984.8	946.2
13	5180	**Limit Domestic and Related In-Home Supportive Services**	0.0	163.8	163.8
14	5225	**Division of Juvenile Justice Realignment**	-10.0	11.2	1.2
15	5225	**Expand Alternative Custody for Women**	0.0	0.0	0.0
16	6110/6870	**Proposition 98**	171.2	373.2	544.4
17	6110	**Non-Prop 98 Child Nutrition**	0.0	10.4	10.4
18	6110	**AVID Program**	0.0	8.1	8.1
19	6110	**Non-P98 State Special Schools**	0.0	1.8	1.8
20	6110	**Non-98 Child Care**	0.0	446.9	446.9
21	6120	**State Library**	0.0	1.1	1.1
22	7980	**Cal Grant Program**	0.0	301.7	301.7
23	7980	**Eliminate Loan Assumption Programs for Teachers and Nurses**	0.0	6.6	6.6
24	8885	**Defer Pre-2004 Mandate Obligations**	0.0	99.5	99.5
25	8885	**Repeal/Reform/Suspend State Mandates**	0.0	728.8	728.8

Solutions for 2012-13 Governor's Budget

(Dollars in Millions)

	Org	Description	2011-12 or prior	2012-13	2-year total
26	Various	**Efficiencies**	0.0	(95.7)	(95.7)
Expenditure Reductions, Subtotal			$133.2	$4,082.6	4,215.8
Other					
27	2660	**Transfer of additional weight fee revenues to the General Fund**	0.0	349.5	349.5
28	5175	**Suspend County Share of Child Support Collections**	0.0	34.5	34.5
29	7100	**Unemployment Insurance Interest Payment**	0.0	417.0	417.0
30	9620	**Loan Repayment Extensions**	27.0	603.5	630.5
Other, Subtotal			$27.0	$1,404.5	1,431.5
Revenues					
General Fund Revenues					
31	0840	**Unclaimed Property from Insurance Companies**	21.0	48.7	69.7
32	0840	**Unclaimed Property Fraudulent Claims Prevention and Detection Program**	0.0	7.9	7.9

Solutions for 2012-13 Governor's Budget

(Dollars in Millions)

	Org	Description	2011-12 or prior	2012-13	2-year total
33	3560	**State Lands Lease Compliance and Royalty Recovery**	0.0	5.6	5.6
34	Majors, 0860,6110 6870	**Extend Financial Institutions Data Match to BOE and EDD, related State Ops Costs, and Allocate FIRM Increases to Schools and Community Colleges**	4.0	10.6	14.6
				-9.0	-9.0
			(4.0)	(1.6)	(5.6)
35	Majors, 6110, 6870	**PIT and SUT Rate Increases: Funds for Use by Local School Districts and Community Colleges**	2,245.0	4,690.0	6,935.0
			0.0	-2,534.2	-2,534.2
			(2,245.0)	(2,155.8)	(4,400.8)
<u>Special Fund Revenues</u>					
36	4260	**Medi-Cal: Extend the Gross Premiums Insurance Tax on Medi-Cal Managed Care Plans**	0.0	161.8	161.8
37	7100	**Unemployment Insurance Fund Insolvency**	0.0	0.0	0.0
Revenues, Subtotal			$2,270.0	$2,381.4	4,651.4
Total Solutions			**$2,430.2**	**$7,868.5**	**$10,298.7**

Solutions for 2012-13 Governor's Budget

(Dollars in Millions)

Org	Description	2011-12 or prior	2012-13	2-year total
Solutions by Category		**2011-12**	**2012-13**	**Total**
Expenditure Reductions		133.2	4,082.6	4,215.8
Revenues		2,270.0	2,381.4	4,651.4
Other		27.0	1,404.5	1,431.5
Total		**2,430.2**	**7,868.5**	**10,298.7**