



COMMITTEE ON BUDGET & FISCAL REVIEW
Room 5019, State Capitol
Sacramento, CA 95814

SENATOR MARK LENO, CHAIR

MAJOR ACTION REPORT

June 28, 2011

The purpose of this Major Action Report is to provide a review of the package of budget solutions proposed for adoption on June 28, 2011 to balance the 2011-12 budget.

A more-detailed analysis of the 2011-12 budget – the Final Action Report – will be released by the Committee after the Governor has acted on all budget-related bills.

If you have additional questions, please contact the Committee at (916) 651-4103.

2011-12 Budget Package

Legislature and Governor Move Balanced Budget Forward

In January, the estimated General Fund (GF) shortfall was \$27.6 billion – including a \$1.0 billion reserve and including the cancelation of the sales-leaseback transaction. In March, the Legislature passed \$14 billion in solutions, primarily spending reductions.

The Legislature adopted most of the Governor’s May Revision framework that relied on approximately \$11 billion in additional revenues. However, after failing to gain the Republican votes needed to move forward the revenue portions of the Governor’s framework, the Legislature identified alternative solutions and adopted a budget on June 15 which was subsequently vetoed by the Governor.

The Legislature and Governor have since identified additional alternative solutions, as well as retained many of the solutions from the June 15 budget, to ensure a balanced budget in 2011-12. In addition to the reductions already adopted, the final version of the budget incorporates the following major changes to balance the budget for 2011-12 without revenues that require a two-thirds majority vote.

The Legislature and Governor have identified \$12.7 billion in additional solutions, which will replace tax revenues and result in a slightly lower budgetary reserve of approximately \$500 million GF in the budget year. The major solutions include the following:

The solutions by category – based on the January Budget problem and including March legislation – are as follows (based on June 28 Finance scoring):

Expenditure Reductions	\$15.0 billion
Other, including delayed loan repayments	\$2.9 billion
Revenues	\$0.7 billion
Special Fund Revenues	\$0.2 billion
<u>Natural Revenue Growth/Misc. Changes</u>	<u>\$8.3 billion</u>
TOTAL	\$27.1 billion
Reserve	\$0.5 billion

A summary of the key components of the \$12.7 billion in solutions are outlined below:

Adopt additional expenditure reductions:

- Reduces K-14 Proposition 98 funding by approximately \$3 billion by continuing deferrals of \$3 billion. The final version also eliminates the additional \$744 million in settle up payments assumed in the June 8 legislative version.
- The budget package includes a solution from redevelopment agencies (RDAs) that provides a \$1.7 billion General Fund benefit in 2011-12.
- The budget package includes \$448 million in unallocated General Fund reductions to the Medi-Cal and Healthy Family programs.
- Includes a \$150 million reduction to the University of California system, in addition to the \$500 million reduction included in the budget package passed in March, and budget bill language to prevent reversion of funds if enrollment targets are not met.
- Includes a \$150 million reduction to the California State University system in addition to the \$500 million reduction included in the budget package passed in March, and budget bill language to prevent reversion of funds if enrollment targets are not met.
- Includes an additional \$150 million reduction to the trial court system, in addition to the \$200 million reduction included in the budget package passed in March, and \$310 million in savings from a one-year pause in court construction projects.
- Reduce funding for state Division of Juvenile Justice (DJJ) by collecting \$72 million in additional “sliding scale” fees paid by counties for commitments to DJJ.
- Includes \$36 million from savings in various state law enforcement programs in the Department of Justice.
- Adopts \$41 million in savings from dedicating surplus county office of education property tax balances that are currently restricted to other education programs, thereby reducing State GF costs.
- Achieves \$12.1 million in savings from postponing the opening of the Redding and Fresno Veterans Homes of California (these homes were slated to open in late spring 2012).

- Assumes \$10.6 million in savings from revised estimates of debt service costs for general obligation bonds.
- Assumes \$12.8 million in additional risk-based reductions made to the CAL FIRE fire protection program.
- Assumes additional \$4 million General Fund reduction to the California Department of Food and Agriculture.
- Assumes an additional \$25 million unallocated reduction to state operations.
- Achieves various one-time savings of \$86 million in the 2010-11, including from reduced borrowing costs and reconciliation of employee compensation costs.

Adopt majority vote revenues:

- Increases vehicle registration fees by approximately \$12 to defray the costs associated with the Department of Motor Vehicles. This action frees up \$300 million in vehicle license fees to be dedicated to local public safety realignment.
- Increases compliance in collection of the use tax, by requiring collection of the existing tax by online retailers, as specified - \$200 million in additional revenues are assumed.
- Adopts a State Responsibility Area Fee to cover some costs of state fire suppression on privately-owned lands. Reduces General Fund support for Cal-Fire by \$50 million and replaces with fee revenue (savings grows to \$200 million in out-years).
- Assumes an additional \$11.5 million in State Water Resource Control Board programs is shifted from General Fund to special funds supported by fees.

Updated funding for realignment:

- Assumes that 1.06 percent of the existing state sales tax be redefined as a local revenue to support \$5.1 billion in public safety programs proposed for realignment from the state to local governments in the budget year.

- Assumes redirection of vehicle license fee (VLF) revenues from the following sources to support public safety programs proposed for realignment from state to local governments in the budget year:
 - \$300 million from the Department of Motor Vehicles
 - \$106 million from cities
 - \$48 million from Orange County

Updated assumptions:

- Increases current-year revenue estimates by \$1.2 billion to reflect higher revenues already received since the May Revision estimates.
- Assumes current revenue trends continue and generate approximately \$4 billion above the revenue estimates in the Governor’s May Revision for the 2011-12 year. This is consistent with the most recent data on revenues collected by the State since the Governor’s May Revision was released.

Based on preliminary scoring, the 2011-12 budget includes General Fund expenditures of \$86 billion, down from revised 2010-11 expenditures of \$91.5 billion.

However, in the case that revenues are not achieved in the budget year, the budget package contains an additional \$2.5 billion in additional “trigger” cuts. These cuts would be triggered only if revenues to the state do not achieve levels assumed in the budget package. If revenues are \$1 billion below assumptions, \$600 million in additional reductions will be made on January 1, 2012 to a variety of programs but excluding K-12 education. If revenues are \$2 billion below assumptions, an additional \$1.9 billion in cuts will be made to K-12 education on February 1, 2012.

Major Expenditure Reductions

Overall, the final version of the budget without the maintenance of existing tax revenues relies on significant reductions in most areas of the budget.

K-12 Education. The final version of the budget includes funding for Proposition 98 that is at about the same level as the current fiscal year. The lower spending on Proposition 98 is a result of not including the Governor's proposed taxes requiring a two-thirds vote in the final budget package. Overall Proposition 98 expenditures will be approximately \$48.3 billion in the budget year (excluding child care, but including preschool). Major proposals included in the final budget include the following:

- **Deferrals:** Continues approximately \$3 billion in inter-year K-12 payment deferrals, consistent with the Governor's January proposal.
- **Realignment Revenues:** Approves \$2.1 billion rebench of the Proposition 98 minimum guarantee to reflect the dedication of 1.06 percent of the state sales tax to a local revenue fund to support public safety realignment in 2011.
- **Child Care:** Approves \$1.5 billion rebench of the Proposition 98 minimum guarantee to reflect removing all child care programs except preschool out of Proposition 98.
- **Student Mental Health Services:** Approves Governor's budget proposal to rebench the Proposition 98 guarantee by \$222 million to fund mental health related services for students with disabilities (previously provided by counties per the AB 3632 mandate). Also augmented 2010-11 funding by \$80 million to partially backfill for a funding shortfall created when Governor Schwarzenegger vetoed funding for the AB 3632 mandate.
- **Class Size Reduction:** Approved a one-year extension of the continuous appropriation for the class size reduction categorical program.
- **Categorical Flexibility:** Approved the Governor's proposal to extend various flexibility options to school districts for an additional two years.
- **Secretary of Education Elimination:** Approved the Governor's proposal to eliminate the Office of the Secretary of Education.

Childcare. Approved \$300 million in ongoing savings to childcare programs. This is approximately \$200 million less than was previously eliminated in March due to the following actions:

- **Standard Reimbursement Rate Reduction:** Restored 10 percent rate cut to the Title V contracts.
- **Contract Reduction:** Reduced contracts, or slots, including preschool, by 11 percent instead of 15 percent.
- **11 and 12-Year Olds:** Continued funding childcare services for 11 and 12-year olds.
- **Family Fees:** Rejected earlier proposal to increase sharply the family fees paid by low-income individuals for childcare services.

In addition, as referenced above, all non-pre-school child care programs were removed from within the Prop. 98 guarantee, and funded in the regular General Fund budget.

Higher Education. Adopted a \$650 million reduction to the University of California, a \$650 million reduction to the California State University, and a \$400 million reduction to the California Community Colleges. Some of these cuts in each segment will be offset with student fees.

Health and Human Services. Achieved total expenditure cuts of around \$5.0 billion in the Health and Human Services area as follows:

- **Medi-Cal:** Achieved over \$1.6 billion in GF expenditure cuts in the Medi-Cal program. Enacts provider payment reductions of up to 10 percent for Managed Care and Fee-for-Service for savings of \$547 million. Approved many of the Governor’s “co-pays” and “hard caps” on services, but rejected the hard-cap on physician and clinic visits, medical supplies, equipment, and prescriptions. Found other savings not identified by the Governor.
- **Adult Day Health Care (ADHC):** Approved the Governor’s proposal to eliminate this Medi-Cal benefit but provided \$85 million (General Fund) and corresponding federal funds to provide a transition program for existing ADHC enrollees to other Medi-Cal appropriate services. In addition, crafted pending legislation for the DHCS to develop a new federal Waiver to recast these services.

- **Multipurpose Senior Service Program (MSSP):** Rejected the full elimination of this program and instead reduced funding by \$2.5 million or 13 percent.
- **Proposition 63:** Approved the shift of about \$860 million in Proposition 63 funds from counties on a one-time basis to backfill for General Fund support for the Early and Periodic Screening, Diagnosis and Treatment Program, Medi-Cal Specialty Mental Health Managed Care and mental health services to pupils enrolled in Special Education.
- **Developmental Services:** Adopted over \$577 million (General Fund) in reductions in Developmental Services, including federal fund shifts, cuts to Developmental Centers, reductions to the Purchase of Services, and reductions to administrative functions.
- **SSI/SSP:** Approved the Governor's proposal to reduce Supplemental Security Income/State Supplementary Payment (SSI/SSP) to the minimum allowed by a federal maintenance of effort requirement for savings of \$192 million.
- **CalWORKs:** Achieved about \$1 billion in expenditure cuts in the CalWORKs program. Approved an eight percent grant cut to save \$300 million. Approved the Governor's proposal to reduce the time-limit for adults to receive assistance from 60 months to 48 months, but rejected the Governor's proposal to apply a 48-month time limit to safety net and child-only cases. Approved the Governor's cut to the county single allocation of approximately \$377 million. Added savings of \$100 million from adjusting the earned-income disregard.
- **IHSS:** Achieved the Governor's savings number of \$486 million in the In-Home Supportive Services (IHSS) program, but reduced the proposed across-the-board service cut and the proposed domestic and related cut. Found other savings not proposed by the Governor, such as the Community First Choice Option to obtain \$121 million in additional federal funds.

Corrections: Approved expenditure reductions of about \$1.0 billion in Corrections mainly due to the realignment proposal. However, the Legislature has also approved the Governor's workforce cap proposal for an additional \$195 million and significant reductions to the Board of Parole Hearings operations. Furthermore, the Legislature has restored nearly \$50

million in community-based rehabilitation contracts that will be needed as the State implements realignment.

Courts: Approved the Governor's proposal to reduce the courts funding by \$200 million. Also approved an additional \$150 million reduction to the courts and a \$310 million in one-time savings from delaying court construction projects.

Transportation: Approved the Governor's proposal to use truck weight fees to pay about \$1.0 billion in transportation-related general obligation bond debt. Approved re-enactment of the 2010 Tax Fuel Swap to conform to the requirements of Proposition 26.

Redevelopment: The final version of the budget includes a solution from redevelopment agencies (RDAs) that provides a \$1.7 billion General Fund benefit in 2011-12, and creates a voluntary alternative redevelopment program that allows RDAs to continue with reform.

Local Government: Approved the Governor's proposal to suspend the Williamson Act / Open Space Subvention for a two-year savings of \$20 million.

Natural Resources and Energy: Approved a cut of \$155 million in energy efficiency programs funded by the Gas Consumption Surcharge Tax. Approved cuts of \$11 million to State Parks and \$10 million to Off-Highway Vehicle Parks. Also approved \$50 million reduction to CAL FIRE, to be backfilled with new revenues from a State Responsibility Area (SRA) Fee to be paid by homeowners within the SRA. Also assumes \$11 million in savings from new water quality fees, and \$12.8 million in savings to Cal FIRE's Fire Protection Program resulting from the department's risk-reduction strategy reviews.

Government Efficiency and Employee Compensation: Approved expenditure cuts of about \$700 million in areas such as: employee compensation (\$308 million); employee healthcare (\$80 million); and other state operations-related governmental efficiencies (\$269 million), which is discussed further in Page 12 of this document.

Revenues

Revenue Package. The final version of the budget does not include the Governor's proposal to maintain 2010 tax rates for five years. This and the Governor's proposal to reform enterprise zones and implement a single sales factor for apportioning corporate income to California would have generated \$11 billion in the current and budget years. This would have resulted in \$1.7 billion in additional expenditures for Proposition 98.

The final version does include the following majority vote revenues:

- Increases vehicle registration fees by approximately \$12 to defray the costs associated with the Department of Motor Vehicles. This action frees up \$300 million in vehicle license fees to be dedicated to local governments that can be used as a down payment for the implementation of public safety realignment.
- Increases compliance in collection of the use tax, by requiring collection of the existing tax by online retailers, as specified. \$200 million in additional revenues are assumed.
- Adopts a State Responsibility Area Fee to cover some costs of state fire suppression on privately-owned lands. Reduces General Fund support for CAL FIRE by \$50 million and replaces with fee revenue.
- Assumes an additional \$11.5 million in State Water Resource Control Board programs is shifted from General Fund to special funds supported by fees.

PUBLIC SAFETY REALIGNMENT

The final version includes \$5.5 billion to fully-fund the revised public safety realignment program. About \$5 billion of this comes from reestablishing of a portion of the state sales tax revenues as a local sales tax, dedicated for the realigned programs. In addition, about \$453 million in vehicle license fee revenues is being redirected from the support of the Department of Motor Vehicles, and local governments to provide the balance.

The Legislature passed AB 109 in March that realigned low-level offenders from state prison to a local jurisdiction. This policy change will go into effect October 1, 2011, when funding is provided for a Community Corrections Grant Program. This budget package funds the Community Corrections Grant Program with about \$1.6 billion.

The realignment plan will enable the state to meet the order set out by a recent 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 has significant potential benefits for public safety. Funded realignment will allow for funding to flow with the offender back to the community where it can be invested in support services, programs, and law enforcement that enhance the safety of communities.

Other public safety programs not directly related to the implementation of AB 109 will continue with minimal changes until additional 2011 realignment legislation can be enacted later this legislative session. This includes funding for child welfare services, mental health services, substance abuse treatment, and adult protective services.

The public safety realignment fully funds the local public safety programs that had previously been funded by a dedicated 0.15 percent of the vehicle license fee (the 0.15 percent will expire on June 30).

REDUCING STATE GOVERNMENT

Legislature Streamlines Government and Achieves Savings Related to the Elimination of 23 Boards & Commissions

The budget package achieves savings related to 23 eliminations and 14 program reductions that were proposed in the Governor's May Revision. The Legislature also adopted policy to put in motion a major reorganization and consolidation of various health care programs that when fully implemented may result in the further elimination of additional agencies. These actions will help the Governor achieve the \$269 million GF savings related to efficiencies in state government operations. The mechanism to achieve these savings is a budget control section that provides the Administration with the authority to make the required budgetary reductions to achieve the total savings.

The Administration has identified, and in some cases already achieved, savings through a variety of executive actions, including eliminating the offices of the Secretary of Education and the American Recovery and Reinvestment Act Inspector General, banning non-essential travel, implementing a statewide building rental rate reduction, reducing the number of state-issued cellular phones, and reducing the statewide vehicle fleet, including the elimination of any non-essential vehicles and reducing the number of home-storage permits.