Governor's Budget MAY REVISION *2012-13*

Edmund G. Brown Jr. Governor, State of California

Introduction

A year ago, the state faced an immediate $26.6 billion budget shortfall and future estimated annual gaps of $20 billion. The state's fiscal challenges were exacerbated by an unprecedented level of debts, deferrals, and budgetary obligations accumulated over the prior decade.

The 2011 Budget Act made substantial progress in returning the state to fiscal stability, but more work remains. The Governor's Budget estimated that the state faced a $9.2 billion budget problem for 2012-13. The May Revision, however, estimates that the problem has increased to $15.7 billion as a result of a reduced revenue outlook, higher costs to fund schools, and decisions by the federal government and courts to block budget cuts.

The May Revision builds upon the key principles underlying the enacted 2011-12 Budget and the Governor's Budget protecting education and public safety programs, making government more efficient and less costly, moving government closer to the people, and paying down debt. While requiring more difficult cuts than originally anticipated, the May Revision will restore fiscal balance and make California more attractive for business, investment, and the creation of jobs.

Substantial Progress Has Been Made

The enacted 2011-12 Budget substantially shrank the state's ongoing deficit and rejected the past approach of over-relying on one-time solutions.

The 2011-12 Budget reflected the following:

- Passing an on-time budget that avoided the gimmicks of prior budgets.
- Closing more than half of the state's ongoing budget shortfall. A year ago, the gap stood at about $20 billion; it is now estimated to have shrunk to about $8 billion.
- Realigning public safety programs to bring government closer to the people.
- Eliminating redevelopment agencies to increase funding for schools, police, fire, and other core local services.
- Making tough cuts across state government to reduce General Fund spending as a share of the economy to its lowest level since 1972-73. State Supplementary Payment grants were reduced to 1983 levels. CalWORKs grants were reduced to below 1987 levels. General Fund support for the state's universities was cut by nearly 25 percent. General Fund support for the state's courts was cut by about 20 percent. The Williamson Act subventions were eliminated, and the child care and dependent tax credit was eliminated.
- Protecting education, public safety, and other core state services to the extent possible.
- Reducing the state's cash-flow borrowing, and saving hundreds of millions of dollars in short and long-term borrowing costs.
- Improving management of the state's infrastructure projects by committing available cash to shovel-ready projects and avoiding unnecessary debt.

Through the budget and executive action, the Administration has focused on shrinking state government and making it more efficient. These changes will help the state keep its budget balanced for the long term. Progress includes:

- Reducing the state workforce by more than 30,000 positions on a permanent basis. The state workforce is at its lowest level as a share of the state's population in almost a decade. California already had the nation's fifth lowest level of government employment in 2010.

- Launching a downsizing plan for the California Department of Corrections and Rehabilitation. The plan is a long-term strategy to save billions of dollars, conform the prison system to post-realignment population changes, satisfy the U.S. Supreme Court's order requiring reduced crowding, end federal court oversight in health care and other areas, and improve rehabilitation programs to reduce recidivism. It will reverse the trend of prison spending consuming a growing percentage of the General Fund budget—from 11 percent to 7.5 percent.

- Eliminating 20 boards, commissions, task forces, offices, and departments. The Governor's Budget and the May Revision combined propose to eliminate more than 60 additional entities and programs.

- Reorganizing state government to improve the management and coordination of government activities, facilitate further efficiencies and reduce costs. The Administration submitted its reorganization plan to the Legislature on May 3. The plan cuts the number of state agencies from 12 to 10 and consolidates and aligns related programs and departments.

The 2012-13 Budget Shortfall

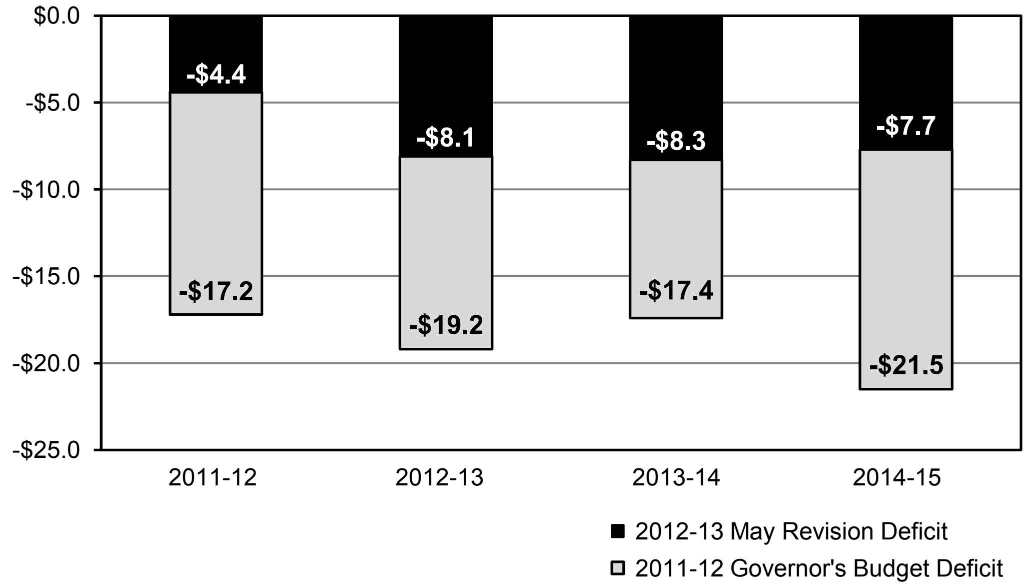
In January, the budget shortfall was estimated to be $9.2 billion. The May Revision estimates that the gap has increased to $15.7 billion. Absent actions to eliminate the structural gap between revenues and expenditures, the state would face about an $8 billion budget shortfall each year. As shown in Figure INT-01, the ongoing budget problem is much smaller than what the state faced just over a year ago. The May Revision proposes to close the remaining gap.

The $6.5 billion increase in the size of the 2012-13 budget problem is largely attributable to three factors:

- *Prior Revenue Forecast Was Too High ($4.3 billion)*—Finance's January forecast was too reliant on strong April and June 2011 receipts, which have now been wiped out by weak final payments received in April 2012. The May Revision continues to project a modest economic recovery.

- *Proposition 98 Spending Increases ($2.4 billion)*—Proposition 98 funding for K-14 education relies on year-to-year changes in revenues. Under the revenue forecast, 2011-12 revenues have decreased ($3.1 billion), and 2012-13 revenues, while lower than in January, are increasing by 5.9 percent. The resulting year-over-year increase

Figure INT-01
Annual Budget Shortfall Reduced by More than Half from $20 Billion to $8 Billion
(Dollars in Billions)



in revenues means the state must pay an additional $1.2 billion for K-14 education. In addition, lower property tax estimates have increased General Fund costs.

- *Federal Government and Courts Blocked Budget Cuts ($1.7 Billion)*—The federal government and courts continue to block reasonable measures to reduce the state's spending. These measures include requiring co-payments for Medi-Cal services, an In-Home Supportive Services (IHSS) provider fee, and cuts to Medi-Cal providers. By blocking these measures, the federal government and courts are forcing the state to pursue even deeper reductions elsewhere. Similarly, further cuts will be required because the federal Receiver for prison medical services overspent his budget by $428 million.

The cost increases are somewhat offset by a net reduction of $1.9 billion from a variety of other factors, such as lower-than-expected caseloads.

Additional Difficult Spending Cuts Are Necessary

As described above, the 2011 Budget Act made deep cuts in state spending, bringing General Fund spending as a share of the economy down to its lowest level since 1972-73. The Governor is seeking additional tax revenues to mitigate the need for deeper cuts to education and public safety. These revenues, however, will not be sufficient to close the entire budget gap. In January, the Governor's Budget proposed difficult spending reductions across state government. These reductions were proposed to permanently reduce spending to a sustainable level and to:

- Protect education and public safety to the greatest extent possible.
- Provide a basic safety net for the most vulnerable.
- Restructure programs to improve outcomes and reduce spending.
- Use alternative funding sources where available.

For instance, the Governor's Budget proposed refocusing CalWORKs and subsidized child care by increasing income support to working families and reducing assistance to families who are not meeting work requirements. The Governor's Budget also proposed to merge the delivery of services for those who are eligible for both Medi-Cal and Medicare to reduce costs and improve the coordination of services.

With the larger budget gap, the May Revision proposes $4.1 billion in additional spending reductions, for a total of $8.3 billion of reductions as summarized in Figure INT-02.

These reductions include:

- Using local reserves to offset General Fund costs for local trial courts on a one-time basis and pausing the court construction program for another year. Commensurate with the offset, the May Revision proposes to evaluate the progress achieved in meeting the goals of trial court reform enacted in 1997. While the state has reduced its General Fund support for courts in recent years, alternative funding from increased fees and transfers have kept overall court funding relatively stable. (Savings of $544 million with ongoing reductions of $125 million)
- Implementing various reductions to hospital and nursing home funding to lower Medi-Cal costs.(Savings of $396 million)
- Reducing IHSS hours by 7 percent. (Savings of $99 million)

Figure INT-02
Budget Balancing Proposals
(Dollars in Millions)

Expenditure Reductions		
Health and Human Services		
Medi-Cal	$1,219.2	
CalWORKs	879.9	
In-Home Supportive Services	224.5	
Other Health and Human Services Programs	161.0	
Education		
Proposition 98	1,497.9	
Child Care	452.5	
Cal Grant Program	291.7	
Other Education	64.4	
All Other Reductions		
Redevelopment Assets	1,405.0	
State Mandates	828.3	
Judiciary	544.0	
Employee Compensation	401.7	
Other Reductions	333.4	
Expenditure Reductions	**$8,303.5**	**50%**
Revenues		
Temporary Taxes	$5,579.8	
Other Revenues	339.1	
Revenues	**$5,918.9**	**35%**
Other		
Loan Repayment Extensions	$1,158.3	
Transfers and Loans from Special Funds	612.2	
Additional Weight Fee Revenues	385.2	
Unemployment Insurance Interest Payment	312.6	
All Other	49.6	
Other	**$2,517.9**	**15%**
Total	**$16,740.3**	

- Prohibiting colleges and universities that are unable to meet minimum performance standards from participating in the Cal Grant Program, as well as aligning future student awards to federal financial-need standards. (Savings of $38 million)
- Reducing the cost of state employee compensation by 5 percent through a reduced workweek or a commensurate reduction in work hours and pay. (Savings of $402 million)

- Using proceeds from the recent National Mortgage Settlement to offset existing General Fund costs for assisting homeowners and protecting consumers, rather than creating new programs. (Savings of $292 million)
- Creating a framework to transfer cash assets previously held by redevelopment agencies to cities, counties, and special districts to fund core public services. Assets transferred to schools will offset General Fund costs. (Savings of $1.4 billion)
- Making various adjustments, including using a 2011-12 overappropriation of the minimum guarantee to pre-pay Proposition 98 funding required by a court settlement. (Savings of $1.5 billion)

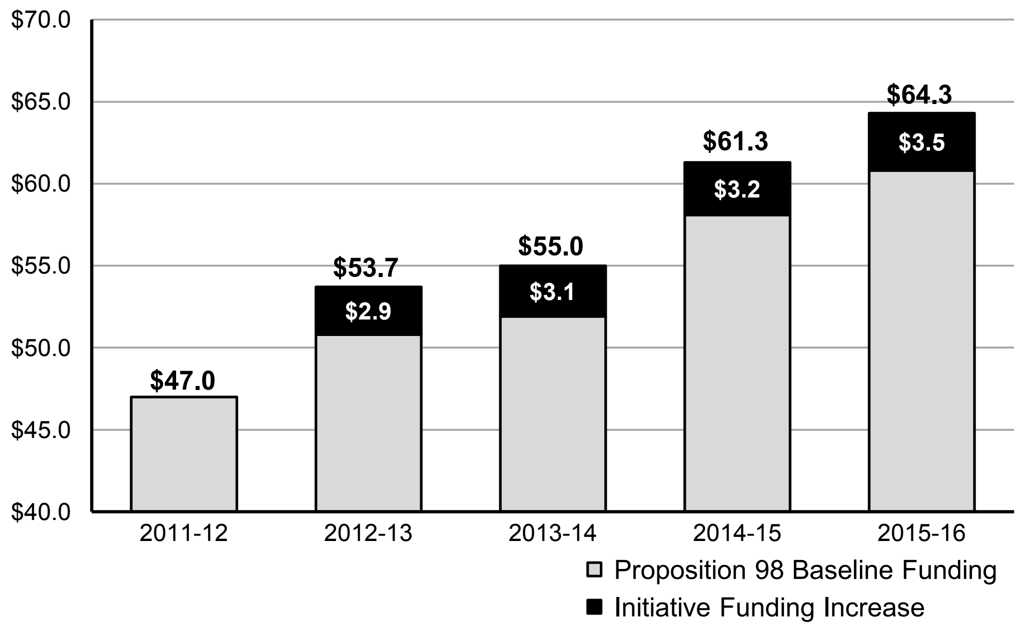
Under the May Revision, General Fund spending for K-14 schools would increase by 16 percent—providing $5.2 billion in additional funding. General Fund spending outside of Proposition 98 would decline by $2.4 billion, or 4.5 percent, excluding a required repayment of $2.1 billion the state borrowed from local government in 2009.

Temporary Taxes to Protect Education and Public Safety

The May Revision assumes the passage of the Governor's proposed initiative at the November election. This measure temporarily increases the personal income tax on the state's wealthiest taxpayers for seven years and increases the sales tax by one-quarter percent for four years. The measure guarantees these new revenues to schools. The measure will generate an estimated $8.5 billion through the budget year. These revenues will enable the state to meet its existing Proposition 98 obligation and to increase funding for schools and community colleges by an additional $2.9 billion. The measure will provide a net benefit to the General Fund of $5.6 billion. In addition, the measure constitutionally guarantees the 2011 Realignment funds for local public safety. The measure will prevent deeper cuts to schools, protect local public safety funding, and assist in balancing the budget.

The May Revision reverses years of cuts in funding for schools and community colleges. As shown in Figure INT-03, K-14 education funding would increase by $17.3 billion, or 37 percent, and per pupil funding would increase by over $2,500 in the next four years. The May Revision dedicates these increased funds to restore cuts, to increase flexible funding for schools, to better meet the needs of low-income students and English language learners, and to pay off deferrals. The proposed weighted student formula,

Figure INT-03
K-14 Funding Increases by $17 Billion Over 4 Years
(Dollars in billions)



as modified, would make school funding more transparent and would give local decision makers greater flexibility.

Alternative to Revenues Is Deeper Cuts

The California Constitution requires that the annual state budget be balanced. To pay the state's bills on time, the budget must be credible and financeable. After more than a decade of putting off dealing with its budget problems, the state must restore a long-term balance between its revenues and spending. Consequently, the May Revision proposes a backup plan if the ballot measure is not approved.

To balance the budget in an ongoing manner, the deep reductions enacted last year and proposed this year must be made and maintained. Without additional revenues, deeper cuts will be required. As education spending accounts for 53 percent of General Fund spending and the May Revision substantially increases K-14 spending and protects the University of California and California State University from deeper cuts, schools and universities would be most affected without the additional revenues.

The ballot trigger cuts totaling $6.1 billion, as summarized in Figure INT-04, would go into effect on January 1, 2013:

Figure INT-04

Ballot Trigger Reductions

(Dollars in Millions)

Expenditure Reductions	2012-13
Proposition 98	$5,493.6
University of California[1/]	250.0
California State University[1/]	250.0
Developmental Services	50.0
Local Water Safety Patrol	10.6
Department of Forestry and Fire Protection	10.0
Flood Control	6.6
Fish and Game: Non-Warden Programs	2.5
Park Lifeguards	1.4
Fish and Game: Wardens	1.0
Department of Justice	1.0
Park Rangers	0.1
Total	**$6,076.8**

1/ This level of savings may be offset by Cal Grant increases if the universities raise tuition.

- Funding for schools and community colleges would be reduced by $5.5 billion. A reduction of this magnitude would result in a funding decrease equivalent to the cost of three weeks of instruction. It would also continue to provide 20 percent of program funds a year in arrears.
- The University of California and California State University would each be reduced by $250 million.
- The state would reduce funding for a variety of public safety programs. The number of the state's public safety officers in the departments of Parks and Recreation (park rangers) and Fish and Game (wardens) would be reduced, and the state would no longer staff its beaches with lifeguards. Grants to local law enforcement for water safety patrol would be eliminated. The Department of Forestry and Fire Protection's firefighting capabilities would be reduced. Flood control programs in the Department of Water Resources would be cut, which would reduce channel and levee maintenance and floodplain mapping. The Department of Justice's law enforcement programs would be reduced.

Restoring and Maintaining Fiscal Stability

The May Revision proposes $16.7 billion in budget-balancing measures to address the state's immediate budget problem and build a prudent $1 billion reserve. Equally important, under current projections, the budget would be balanced on an ongoing basis. In future years, the state would have the capacity to pay down the $33 billion in outstanding budgetary borrowing that was accumulated over the past decade. With diligent fiscal management, the May Revision would reduce this outstanding debt to $6.6 billion by the end of 2015-16.

Even with the balanced budget plan proposed by the May Revision, risks to the budget remain. Potential cost increases associated with actions to reduce the federal deficit, federal government and court decisions, the pace of the economic recovery, an aging population, and rising health care costs all threaten the ability of the state to achieve and maintain a balanced budget over the long term. In addition, the exact level of capital gains and income growth for top earners remains uncertain. The scope of these risks and uncertainties underscores the need to take actions now that improve the state's finances on an ongoing basis.

Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2012-13 May Revision
General Fund Budget Summary
Balanced Budget

(Dollars in Millions)

	2011-12	2012-13
Prior Year Balance	-$2,844	-$2,535
Revenues and Transfers	$86,809	$95,689
Total Resources Available	**$83,965**	**$93,154**
Non-Proposition 98 Expenditures	$53,988	$53,658
Proposition 98 Expenditures	$32,512	$37,729
Total Expenditures	**$86,500**	**$91,387**
Fund Balance	**-$2,535**	**$1,767**
Reserve for Liquidation of Encumbrances	$719	$719
Special Fund for Economic Uncertainties	-$3,254	$1,048
Budget Stabilization Account	**-**	**-**
Total Available Reserve	**-$3,254**	**$1,048**

Figure SUM-02

2012-13 May Revision
General Fund Budget Summary
Problem Definition

(Dollars in Millions)

	2011-12	2012-13
Prior Year Balance	-$2,508	-$6,879
Revenues and Transfers	$83,238	$88,137
Total Resources Available	**$80,730**	**$81,258**
Non-Proposition 98 Expenditures	$54,195	$59,074
Proposition 98 Expenditures	$33,414	$37,157
Total Expenditures	**$87,609**	**$96,231**
Fund Balance	**-$6,879**	**-$14,973**
Reserve for Liquidation of Encumbrances	$719	$719
Special Fund for Economic Uncertainties	-$7,598	-$15,692
Budget Stabilization Account	**-**	**-**
Total Available Reserve	**-$7,598**	**-$15,692**

Figure SUM-03

General Fund Revenue Sources

(Dollars in Millions)

	2011-12	2012-13	Change from 2011-12 Dollar Change	Change from 2011-12 Percent Change
Personal Income Tax	$52,958	$60,268	$7,310	13.8%
Sales and Use Tax	18,921	20,605	1,684	8.9%
Corporation Tax	8,208	8,488	280	3.4%
Motor Vehicle Fees	92	27	-65	-70.7%
Insurance Tax	2,148	2,089	-59	-2.7%
Estate Taxes	-	45	45	-
Liquor Tax	331	337	6	1.8%
Tobacco Taxes	93	90	-3	-3.2%
Other	4,058	3,740	-318	-7.8%
Total	**$86,809**	**$95,689**	**$8,880**	**10.2%**

Note: Numbers may not add due to rounding.

Figure SUM-04

2012-13 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2011-12
Personal Income Tax	$60,268	$1,338	$61,606	$7,569
Sales and Use Tax	20,605	10,390	30,995	2,338
Corporation Tax	8,488	-	8,488	280
Highway Users Taxes	-	5,670	5,670	39
Motor Vehicle Fees	27	5,705	5,732	-158
Insurance Tax	2,089	436	2,525	112
Estate Taxes	45	-	45	45
Liquor Tax	337	-	337	6
Tobacco Taxes	90	757	847	-29
Other	3,740	12,718	16,458	1,495
Total	**$95,689**	**$37,014**	**$132,703**	**$11,697**

Note: Numbers may not add due to rounding.

Figure SUM-05

2012-13 Total Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$2,074	$2,920	$220	$5,214
State and Consumer Services	689	716	14	1,419
Business, Transportation & Housing	448	7,694	7,644	15,786
Natural Resources	1,921	2,499	864	5,284
Environmental Protection	46	1,043	213	1,302
Health and Human Services	25,963	18,805	159	44,927
Corrections and Rehabilitation	8,889	31	1	8,921
K-12 Education	38,540	87	948	39,575
Higher Education	9,516	40	496	10,052
Labor and Workforce Development	342	397	-	739
General Government:				
Non-Agency Departments	485	1,672	3	2,160
Tax Relief/Local Government	2,531	1,715	-	4,246
Statewide Expenditures	-57	2,332	-	2,275
Total	**$91,387**	**$39,951**	**$10,562**	**$141,900**

Note: Numbers may not add due to rounding.

Figure SUM-06

General Fund Expenditures by Agency

(Dollars in Millions)

	2011-12	2012-13	Change	%
Legislative, Judicial, Executive	$2,541	$2,074	-$467	-18.4%
State and Consumer Services	619	689	70	11.3%
Business, Transportation & Housing	573	448	-125	-21.8%
Natural Resources	1,933	1,921	-12	-0.6%
Environmental Protection	51	46	-5	-9.8%
Health and Human Services	26,772	25,963	-809	-3.0%
Corrections and Rehabilitation	8,082	8,889	807	10.0%
K-12 Education	34,038	38,540	4,502	13.2%
Higher Education	9,770	9,516	-254	-2.6%
Labor and Workforce Development	354	342	-12	-3.4%
General Government:				
Non-Agency Departments	443	485	42	9.5%
Tax Relief/Local Government	544	2,531	1,987	365.3%
Statewide Expenditures	780	-57	-837	-107.3%
Total	**$86,500**	**$91,387**	**$4,887**	**5.6%**

Note: Numbers may not add due to rounding.

Economic Outlook

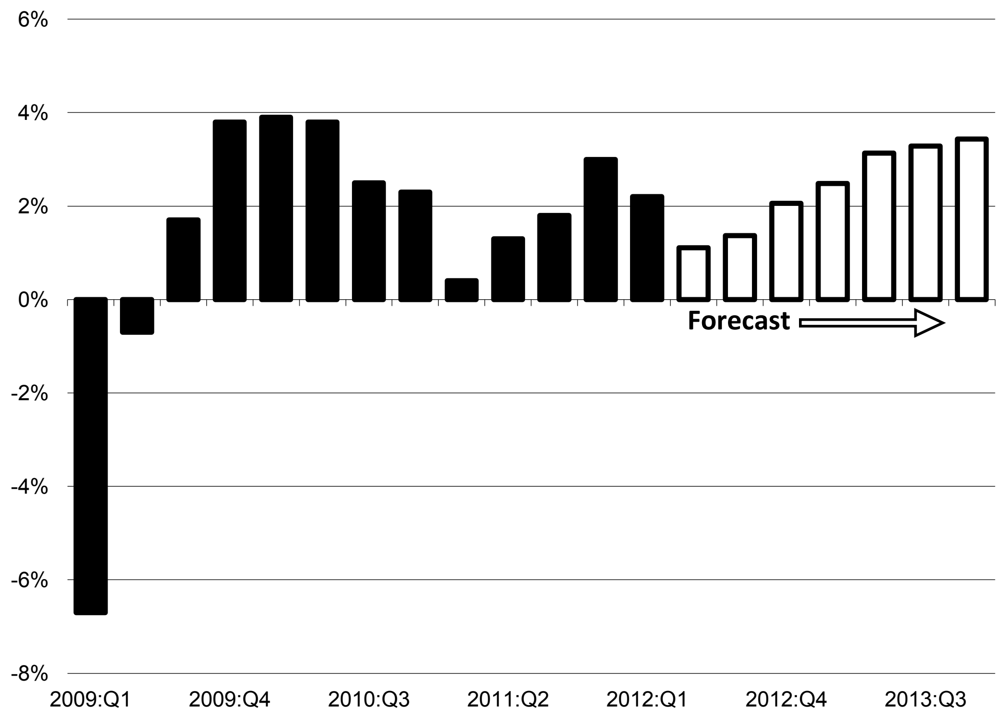
The California and national economies are recovering at a modest pace. The economic outlook has improved slightly since the Governor's Budget. Labor markets made higher gains in the latter half of 2011, but growth moderated in the early months of 2012. Consumer attitudes and spending and business investment have been improving. Gross Domestic Product (GDP) growth is projected at a higher level for 2012 (Figure ECO-01). The risks to recovery are now projected to be much lower. However, real estate conditions and unemployment rates continue to limit growth.

The biggest change in the California outlook stems from incorporating assumptions about the impact of the initial public offering of Facebook stock. It may turn out to be one of the largest initial offerings in U.S. history and far larger than all of the recent offerings in the internet sector. Since the company, its founder, principal employees, and many of its initial investors reside in California, it is projected to have a significant positive impact on California personal income in the latter half of 2012, increasing it by 1.7 percent.

The Nation

The national economy is recovering at a slow, yet steady pace. Labor market conditions are gradually improving. Despite some volatility that was likely caused by an unusually warm winter in many areas of the country, payroll job growth has strengthened.

Figure ECO-01
National Real GDP
Quarter-to-Quarter Growth, Annualized



Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

- Nonfarm employment expanded by 201,000 per month on average during the first four months of 2012, compared to growing 153,000 per month in 2011, and 86,000 per month in 2010.
- The national unemployment rate, while still high at 8.1 percent in April, has been gradually improving since August 2011.
- Initial and continuing claims for unemployment benefits continued a two-year decline during the early months of 2012.

Better employment conditions are translating into rising incomes, better consumer sentiment, and more consumption expenditures.

- Personal income in March 2012 was 3.2 percent above its level of one year ago, while wages and salaries grew 4.4 percent from a year earlier.

- During the first quarter of 2012, consumer sentiment had fully recovered from the mid-2011 slump.
- In February 2012, consumer spending saw its largest gain since July 2011, led by a 900,000-unit increase in vehicle sales. Consumer spending contributed more than 2 percentage points to real GDP growth in the first quarter of 2012.

In addition to consumer spending, rising capital investment has been a significant driver of recent economic growth. Businesses are filling equipment upgrade and replacement needs postponed during the recession. Business spending on equipment and software expanded over 10 percent in 2011—outpacing the growth of all other GDP spending categories.

Rising global demand for U.S. goods and services has been an important component of the recovery. Exports slowed sharply during the recession before rebounding when the recovery began. They grew by more than 11 percent in 2010 and 6.7 percent in 2011. However, the appreciation of the dollar and spreading weakness in the Eurozone will dampen export growth going forward.

The absence of a recovery in real estate markets has been the main drag on the recovery. However, tentative signs have emerged that housing markets may have stabilized.

- In February 2012, the S&P/Case-Shiller 20-City Home Price Index posted its first gain since March 2011.
- The volume of home sales has been on a modest rising trend since the middle of 2011, largely supported by investor purchases.
- The value of homebuilding activity in March was up over 7 percent from a year earlier, with nearly all of the gains coming from multifamily construction.

California

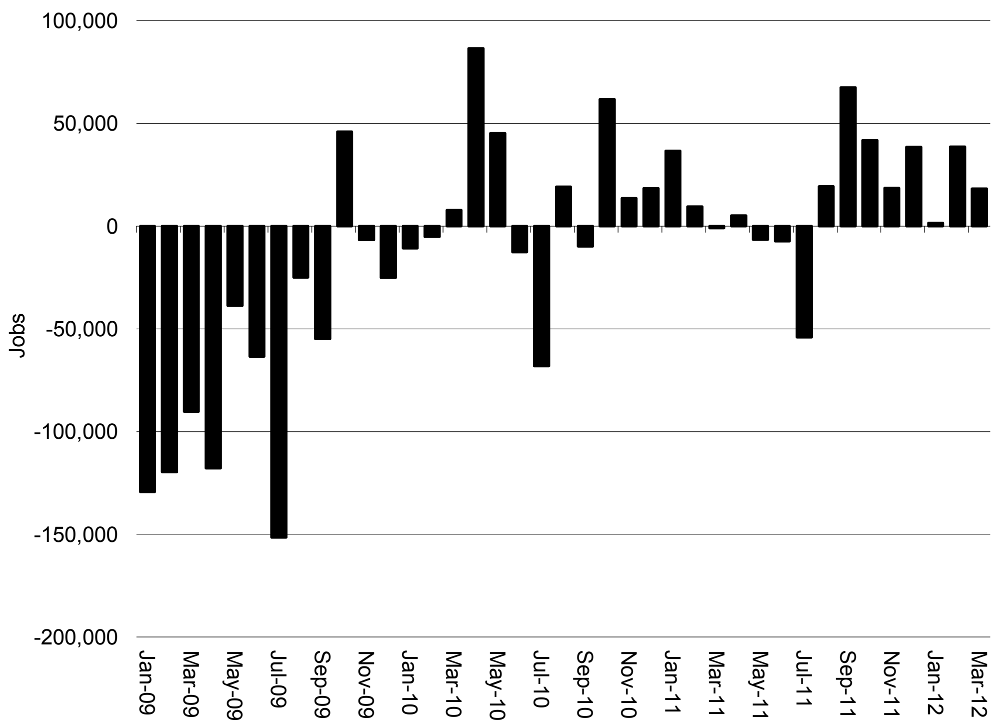
California regions that are home to high-technology, high-wage, and/or export-driven industries are doing relatively well. The remaining areas of the state are still affected by weak housing markets and public sector financial troubles.

California is benefiting from its attractiveness to venture capitalists. In 2011, California accounted for more than half of the entire nation's venture-backed investment—for the fourth consecutive year—led by software and biotechnology. A substantial portion of the state's recent jobs gains stemmed from hiring in high-wage industries such as computer design, semiconductor manufacturing, information technologies, and scientific and technical research. This focus on high-technology industries has boosted California incomes. For example, the Facebook IPO could result in about $12 billion of additional income for California residents in the latter half of 2012.

California continued to benefit from strong export growth. After a 19-percent gain in 2010, California exports rose 11 percent in 2011. Computers, electronics, electronic machinery, and transportation equipment accounted for over 30 percent of this growth. Among recipients, Mexico accounted for nearly 32 percent of the 2011 export gains.

In contrast, labor markets are making slower and less consistent progress. After accelerating in the second half of 2011, nonfarm employment growth slowed at the beginning of 2012—from an average monthly gain of 37,000 jobs during the last five months of 2011 to 19,000 on average during the first three months of 2012 (Figure ECO-02). The fastest growing industry sectors included information; professional, scientific, and technical services; and private educational services.

Figure ECO-02
California Nonfarm Payroll Employment
Month-over-Month Change



Source: Employment Development Department, Labor Market Information Division

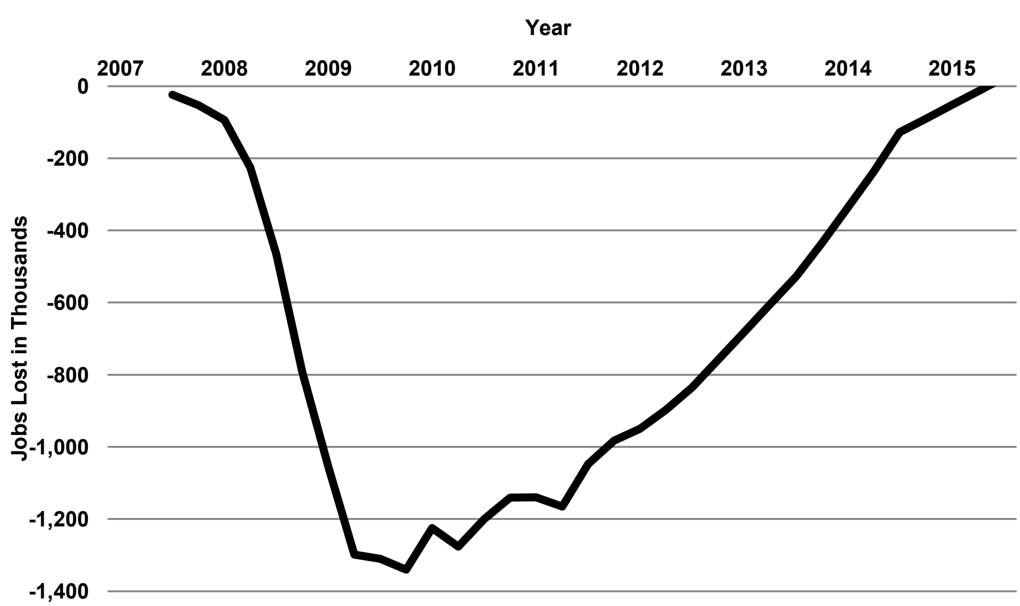
California's housing markets appear to have reached their low points and are recovering slowly.

- Driven to a large extent by investors, home sales have increased from the 469,000-unit pace in the middle of 2011 to a 517,000-unit pace in the first quarter of 2012.
- Although still much higher than historic levels, notices of default have declined to 257,700 in 2011 from their peak of 456,300 in 2009.
- The $268,300 median sales price of existing single-family homes sold in January 2012 was up 8.4 percent from the lowest price recorded during the recession—$247,600 in February 2009.

The Forecast

The outlooks for the nation and California are slightly higher than the Governor's Budget forecast. Both economies are expected to continue to make slow but steady progress. The recovery is on firmer ground, with a much smaller risk of slipping into another recession. As shown in Figure ECO-03, California is forecast to recover the

Figure ECO-03
Jobs Lost During Recession Not Recovered Until 2015



nonfarm jobs lost during the Great Recession in the fourth quarter of 2015, rather than in the second quarter of 2016 as was previously forecast.

Weak housing markets and job growth have made this the slowest recovery in the post-World War II era. Barring serious disruptions, job and wage growth will lead to a balanced expansion. The national economy is forecast for real GDP growth in 2012 and 2013 of 2.2 percent and 2.4 percent, respectively, while 3.4 percent is projected for 2014. The risks to economic recovery are from instability in Europe and the Middle East, as well as potential changes to address the federal deficit.

See Figure ECO-04 and Figure ECO-05 for highlights of the national and California forecasts.

Figure ECO-04

Selected U.S. Economic Indicators

	2011 (Est.)	2012 (Projected)	2013 (Projected)
Real gross domestic product, (2005 dollar) (Percent change)	1.7	2.2	2.4
Personal consumption expenditures	2.2	2.1	2.2
Gross private domestic investment	4.8	9.0	7.0
Government purchases of goods and services	-2.1	-1.6	-1.8
GDP deflator (2005=100) (Percent change)	2.1	1.4	1.4
Federal funds rate (Percent)	0.10	0.10	0.10
Personal income (Percent change)	5.1	3.7	4.2
Corporate profits before taxes (Percent change)	7.9	1.1	0.2
Nonfarm wage and salary employment (Millions)	131.4	133.5	135.7
(Percent change)	1.2	1.6	1.7
Unemployment rate (Percent)	9.0	8.2	7.9
Housing starts (Millions)	0.61	0.74	1.01
(Percent change)	4.3	21.2	36.1
New car and light truck sales (Millions)	12.7	14.2	14.9
(Percent change)	10.3	11.8	4.6
Consumer price index (1982-84=100)	224.9	229.7	234.3
(Percent change)	3.2	2.1	2.0

Forecast based on data available as of April 2012.
Percent changes calculated from unrounded data.

Figure ECO-05
Selected California Economic Indicators

	2011	Percent change	Projected 2012	Percent change	2013	Percent change
Personal income ($ billions)	1,685.8	6.0%	1,769.0	4.9%	1,830.0	3.4%
Nonfarm W&S employment (thousands)	14,085.2	1.1%	14,284.6	1.4%	14,550.9	1.9%
Mining and logging	28.4	5.8%	29.4	3.5%	30.7	4.6%
Construction	559.7	-0.1%	573.9	2.5%	608.5	6.0%
Manufacturing	1,244.6	0.3%	1,255.2	0.8%	1,285.6	2.4%
High technology	345.9	0.7%	348.3	0.7%	359.0	3.1%
Trade, transportation, & utilities	2,661.6	1.5%	2,701.3	1.5%	2,742.3	1.5%
Information	430.2	0.6%	434.0	0.9%	442.0	1.8%
Financial activities	763.1	0.4%	767.7	0.6%	774.7	0.9%
Professional and business services	2,133.8	2.9%	2,212.1	3.7%	2,272.6	2.7%
High technology	334.2	4.7%	348.8	4.4%	363.3	4.2%
Educational and health services	1,834.6	2.6%	1,872.0	2.0%	1,914.9	2.3%
Leisure and hospitality	1,538.3	2.5%	1,568.1	1.9%	1,594.8	1.7%
Other services	492.7	1.6%	500.8	1.7%	513.4	2.5%
Government	2,398.3	-2.0%	2,370.1	-1.2%	2,371.4	0.1%
Unemployment rate (annual average)	11.8%		10.9%		10.4%	
Housing permits (thousands of units)	47	6.2%	53	12.1%	81	53.5%
Consumer price index (1982-84=100)	232.9	2.6%	237.7	2.0%	242.5	2.0%

Forecast based on data available as of April 2012.
Percent changes calculated from unrounded data.

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Revenue Estimates

The May Revision forecasts that baseline General Fund revenues will be lower than at the Governor's Budget by $3.1 billion in 2011-12 and by $1.2 billion in 2012-13. Figure REV-01 shows the baseline revenue forecasts, by source, in the Governor's Budget and the May Revision. The May Revision, before reflecting the related increase in Proposition 98 expenditures, includes a total of $3.6 billion of revenue changes in 2011-12 and $7.6 billion in 2012-13. After taking into account the increase in Proposition 98 expenditures, the net benefit to the budget is $4.6 billion in 2012-13. These changes are shown in Figure REV-02. Total May Revision revenue is expected to be $86.8 billion for 2011-12 and $95.7 billion for 2012-13. Figure REV-03 compares, by source, the Governor's Budget and May Revision revenues.

Accurately forecasting tax revenue for a large and diverse economy like California's has always been a challenging task. That task has become even more challenging in recent years because of several factors. First, the economy is still recovering from the largest recession since the Great Depression. The recovery pattern does not conform to the patterns of other recent economic recoveries. Second, the increasing concentration of income has made tax revenues dependent to a greater degree on the income and decisions of a relatively small population of taxpayers. Third, the use of tax credits and deductions has increased in unpredictable ways. Finally, recent changes to tax laws affect how much tax is owed and when taxes are paid making it increasingly difficult to make accurate predictions based on cash receipts at any point in time.

Figure REV-01
2012-13 May Revision
General Fund Revenue Forecast
Baseline
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 10-11:				
Personal Income Tax	$49,491	$49,445	-$46	-0.1%
Sales & Use Tax	26,983	26,983	$0	0.0%
Corporation Tax	9,614	9,614	$0	0.0%
Insurance Tax	2,077	2,077	$0	0.0%
Vehicle License Fees	1,330	1,330	$0	0.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	334	334	$0	0.1%
Cigarette	96	96	$0	0.0%
Other revenues	2,076	2,076	$0	0.0%
Transfers	1,488	1,488	-$0	0.0%
Total	**$93,489**	**$93,443**	**-46**	0.0%
Fiscal 11-12				
Personal Income Tax	$51,937	$49,803	-$2,134	-4.1%
Sales & Use Tax	18,777	18,921	$144	0.8%
Corporation Tax	9,479	8,208	-$1,271	-13.4%
Insurance Tax	2,042	2,148	$106	5.2%
Vehicle License Fees	80	70	-$10	-12.5%
Estate Tax	0	0	$0	---
Alcoholic Beverage	323	331	$8	2.5%
Cigarette	93	93	$0	0.0%
Other revenues	2,192	2,274	$82	3.7%
Transfers	1,386	1,390	$4	0.3%
Total	**$86,309**	**$83,238**	**-3,071**	-3.6%
Change from Fiscal 10-11	-$7,180	-$10,205		
% Change from Fiscal 10-11	-7.7%	-10.9%		
Fiscal 12-13				
Personal Income Tax	$56,025	$55,495	-$530	-0.9%
Sales & Use Tax	19,595	19,997	$402	2.1%
Corporation Tax	9,342	8,488	-$854	-9.1%
Insurance Tax	2,179	2,089	-$90	-4.1%
Vehicle License Fees	5	3	-$2	-40.0%
Estate Tax	45	45	$0	0.0%
Alcoholic Beverage	329	337	$8	2.4%
Cigarette	90	90	$0	0.0%
Other revenues	2,240	2,146	-$94	-4.2%
Transfers	-529	-554	-$25	4.7%
Total	**$89,321**	**$88,136**	**-1,185**	-1.3%
Change from Fiscal 11-12	$3,012	$4,898		
% Change from Fiscal 11-12	3.5%	5.9%		
Three-Year Total			**-$4,302**	

Figure REV-02

Changes in Revenues

(Benefit to General Fund - Dollars in Millions)

	2011-12	2012-13
Direct General Fund Impact		
Governor's initiative: Temporarily add three new PIT tax brackets for taxable incomes beginning at $500,000 joint with rates of 10.3 percent, 11.3 percent, and 12.3 percent and a 1/4 percent sales tax	$3,139	$5,340
Extend the Finanical Institution Records Match to Employment Development Department and the Board of Equilization	4	11
Changes to FTB wage garnishment authority	11	27
Penalty for filing a fraudulent income tax claim for refund	1	3
Other Revenue Solutions	21	128
Increase in Proposition 98 Expenditures Associated with Major Tax Changes	-	(2,908)
Transfer and Loan Solutions	395	2,043
General Fund Revenue Solutions	**$3,571**	**$4,644**
Other Special Fund Revenues That Offset General Fund Costs		
Extend the Managed Care Organization Taxes for Medi-Cal and Healthy Families	-	$168
Total Net Benefit Of Revenue Solutions	**$3,571**	**$4,812**

From December 2010 through April 2011, revenues were running well ahead of the 2011-12 Governor's Budget forecast released in January 2011. For example, PIT estimated payments in April 2011 showed a 23.6 percent increase over the prior year. This increase in revenue led to an increase in the overall revenue forecast in the 2011 May Revision. After the release of the May Revision, cash receipts for Personal Income Tax (PIT), Corporation Tax (CT), and Sales and Use Tax (SUT) continued to come in well above forecast in May and June. In June, PIT estimated payments were up over the prior year by 20.4 percent. CT payments in June were up 20 percent over the prior year, in spite of a $1 billion corporation tax reduction that took effect for the 2011 tax year. Receipts were so strong that an additional $4 billion of revenue (beyond what was forecast in the May Revision forecast) was assumed in the budget. The $4 billion additional revenue assumption was adopted along with a set of spending cuts that would be triggered in case the higher revenue did not materialize.

Figure REV-03
2012-13 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 10-11:				
Personal Income Tax	$49,491	$49,445	-$46	-0.1%
Sales & Use Tax	26,983	26,983	$0	0.0%
Corporation Tax	9,614	9,614	$0	0.0%
Insurance Tax	2,077	2,077	$0	0.0%
Vehicle License Fees	1,330	1,330	$0	0.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	334	334	$0	0.1%
Cigarette	96	96	$0	0.0%
Other revenues	2,076	2,076	$0	0.0%
Transfers	1,488	1,488	-$0	0.0%
Total	**$93,489**	**$93,443**	**-46**	0.0%
Fiscal 11-12				
Personal Income Tax	$54,186	$52,958	-$1,228	-2.3%
Sales & Use Tax	$18,777	18,921	$144	0.8%
Corporation Tax	$9,479	8,208	-$1,271	-13.4%
Insurance Tax	$2,042	2,148	$106	5.2%
Vehicle License Fees	$80	70	-$10	-12.5%
Estate Tax	$0	0	$0	---
Alcoholic Beverage	$323	331	$8	2.5%
Cigarette	$93	93	$0	0.0%
Other revenues	$2,213	2,295	$82	3.7%
Transfers	1,413	1,784	$371	26.3%
Total	**$88,606**	**$86,809**	**-1,797**	-2.0%
Change from Fiscal 10-11	-$4,883	-$6,634		
% Change from Fiscal 10-11	-5.2%	-7.1%		
Fiscal 12-13				
Personal Income Tax	$59,552	$60,268	$716	1.2%
Sales & Use Tax	$20,769	20,605	-$164	-0.8%
Corporation Tax	$9,342	8,488	-$854	-9.1%
Insurance Tax	$2,179	2,089	-$90	-4.1%
Vehicle License Fees	$5	3	-$2	-40.0%
Estate Tax	$45	45	$0	0.0%
Alcoholic Beverage	$329	337	$8	2.4%
Cigarette	$90	90	$0	0.0%
Other revenues	$2,237	2,275	$38	1.7%
Transfers	841	1,489	$648	77.1%
Total	**$95,389**	**$95,689**	**300**	0.3%
Change from Fiscal 11-12	$6,783	$8,880		
% Change from Fiscal 11-12	7.7%	10.2%		
Three-Year Total			**-$1,543**	

By the time the 2012-13 Governor's Budget revenue forecast was developed, receipts for the three largest tax sources (PIT, SUT, and CT) had continued to come in at or above levels projected in the May Revision forecast through November 2011. PIT September payments were up over 8 percent, even though taxpayers are no longer required to make estimated payments in September. Historically, when cash payments come in higher than forecast, it is an indication that there is underlying strength in the revenue source above the level that had been forecast.

Just after the 2012-13 Governors' Budget forecast was developed, PIT and CT receipts started to fall off dramatically. Although receipts for the first 11 months of 2011 had shown strong growth, receipts for the months of December 2011 through April 2012 showed declines (particularly for PIT and CT) relative to the prior year. December CT estimated payments were down by 12 percent, and December/January PIT estimated payments were down by 13 percent. The drop off in tax receipts, which continued through April, led to a baseline 2012-13 May Revision forecast for 2011-12 that is $3.1 billion lower than the Governor's Budget baseline forecast.

The 2012-13 May Revision Budget forecast for PIT and CT has dropped significantly from the Governor's Budget. Because of the reduced PIT receipts, the May Revision forecast for capital gains growth for 2011 has dropped from a 15 percent increase in January to a 5 percent decline at the May Revision. A year-over-year decline in capital gains is very atypical, other than in recessionary periods. Additionally, new 2010 tax return data suggest that the forecast for business income reported on PIT returns was somewhat optimistic. The reduction in those income items for 2010 leads to a drop in the forecast for these income items for 2011 and later years. Offsetting these declines in income are the revenues expected to be generated through the Facebook initial public offering.

For the CT, receipts have lagged significantly behind the projected and actual levels of corporate profits. It is likely that this decline is significantly due to increased usage of tax credits. The May Revision forecast for CT is down by $1.3 billion in 2011-12 and by $854 million in 2012-13 to reflect the weaker receipts.

The May Revision is based on the assumed passage of the Governor's tax initiative. The Governor's proposal temporarily increases tax rates on the highest income Californians, and temporarily increases the Sales and Use Tax rate by 0.25 percent. These two provisions result in a revenue increase of $8.5 billion. The Governor's initiative will replace some of the revenues lost in the recession as the state's economy slowly recovers.

Solutions and Policy Proposals

The May Revision proposes the following new policy changes that will affect General Fund revenue:

- *Change rules regarding Franchise Tax Board (FTB) wage garnishment* —The May Revision proposes to allow the FTB to issue a wage garnishment against a delinquent income tax debt without requiring FTB to record a tax lien. This provides a benefit to individuals with outstanding tax debts because it removes an incentive for FTB to record the lien. This change is expected to generate $11 million General Fund revenue in 2011-12 and $27 million General Fund revenue in 2012-13.
- *Penalty for fraudulent claim for refund*—Consistent with current federal law, the May Revision Budget would create a penalty for filing a fraudulent claim for refund. This penalty is intended to deter taxpayers from filing amended returns that claim credits that are not substantiated. This program is expected to generate $1 million General Fund revenue in 2011-12 and $3 million General Fund revenue in 2012-13.

Long-Term Forecast

Figure REV-04 shows the forecast for the largest three general fund revenues from 2010-11 through 2015-16. Total General Fund revenue from these sources is expected to grow from $86 billion in 2010-11 to $107.7 billion in 2015-16. The average year-over-year growth rate over this period is 4.8 percent.

The May Revision economic forecast reflects modest but steady growth over the next five years. The projected average growth rate in GDP over the next five years is 2.8 percent, a slightly slower rate than normal for an economic expansion. With the exception of a decrease in the forecast of proprietors' income and national corporate profits, most key drivers of the May Revision forecast, such as total personal income, unemployment rate, wages, and the S&P 500, are projected to be slightly improved in both the short and long term over their projected levels for the Governor's Budget forecast.

Figure REV-04

Long-Term Revenue Forecast - Three Largest Sources

(General Fund Revenue - Dollars in Billions)

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	average year over year growth
Personal Income Tax	$49.4	$53.0	$60.3	$60.2	$67.4	$71.4	7.7%
Sales and Use Tax	$27.0	$18.9	$20.6	$23.0	$24.9	$26.2	0.8%
Corporation Tax	$9.6	$8.2	$8.5	$8.9	$9.6	$10.1	1.3%
Total	**$86.0**	**$80.1**	**$89.4**	**$92.2**	**$101.8**	**$107.7**	4.8%
Growth	--	-6.9%	11.6%	3.1%	10.4%	5.8%	

The total revenue generated by these three sources has grown at an average annual rate of 5 percent since 1987. This forecast estimates a decline in General Fund revenue of 7 percent in 2011-12, followed by growth of 11.6 percent in 2012-13. Growth in 2013-14 is expected to be 3.1 percent, followed by 10.4 percent growth in 2014-15. This choppy year-to-year growth pattern, in part, reflects the expiration of temporary taxes, the dedication of sales tax to realignment in 2011-12 and the potential behavioral impact of federal tax law changes. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 reduced taxes for dividend income, capital gains, and other income. These tax reductions were set to expire after 2010. However, late in 2010 they were extended through 2012. In addition a 3.8-percent surtax on specified unearned income will go into effect on January 1, 2013, as part of federal health care financing. As was done in the Governor's Budget, the May Revision forecast assumes that in 2012 some taxpayers will respond to these rate increases by accelerating 20 percent of 2013 capital gains to 2012. It is also assumed that 10 percent of 2013 dividends and 1.1 percent of wages will be accelerated to 2012. These income shifts push revenue into 2012-13 from 2013-14, and distort the growth rate in 2014-15.

Corporate tax revenue has substantial long-term declines from the Governor's Budget forecast. This is due in part to a lower estimate of national profits both in the short and long-term along with a significant and unexpected increase in the use of tax credits.

Personal Income Tax

The PIT forecast has been reduced by $1.2 billion in 2011-12 and increased by $716 million in 2012-13. Through April, current-year PIT receipts were down $2.8 billion from the Governor's Budget forecast. April's receipts provide a clearer picture of the 2011 tax year. Based on these receipts and the overall economic forecast, it now appears that the Governor's Budget forecast overestimated the strength of capital gains income for the 2011 tax year. Because of this, the forecast growth in capital gains income for 2011 has been decreased from 15 percent growth to a 5 percent decline. Capital gains reported by taxpayers plunged 48.9 percent in 2009 and final data for the 2010 tax year shows that gains in 2010 increased 92 percent.

Offsetting the base revenue declines are an estimated $283 million in 2011-12 and $1.2 billion in 2012-13 from the Facebook Initial Public Offering.

This forecast also reflects the assumed passage of the Governor's tax initiative. These revenue estimates include $3.1 billion in 2011-12 and $4.7 billion in 2012-13 from the assumed addition of three tax brackets for taxable incomes beginning at $500,000 for joint households ($250,000 for single filers) with rates of 10.3 percent, 11.3 percent, and 12.3 percent for seven years.

Sales and Use Tax

The Sales and Use Tax (SUT) forecast includes a baseline increase of $144 million in 2011-12 and $402 million in 2012-13.

For the current year, the SUT forecast is increased by $144 million due to receipts through April and a stronger forecast of economic indicators, most notably lower expected unemployment rates and an uptick in expected inflation from the Governor's Budget estimates.

Overall strength in the forecast continues through 2012-13, with baseline revenues for the year up $402 million from the Governor's Budget. This forecast assumes passage of the Governor's initiative that increases the sales tax rate by 0.25 percent from January 1, 2013, to December 31, 2016.

Corporation Tax

The CT forecast has been decreased by $1.3 billion in the current year and by $854 million in the budget year.

The decline in CT revenues in 2011-12, and 2012-13 since the Governor's Budget forecast are attributable to lower tax receipts in the current year, a lower estimate of taxable profits resulting from a lower estimate of national profits, the increased use of credits, and minor technical changes in the forecast.

Despite the fact that the May Revision economic forecast for corporate profits has been revised downward relative to the Governor's Budget forecast, national corporate profits are still expected to see healthy growth of 7.9 percent in 2011, and 1.1 percent in 2012. This growth in corporate profits does not translate to increased CT revenues in California, largely due to increased usage of credits, as well as the recently enacted legislation allowing the sharing of credits among members of the same unitary group, and allowing the elective use of single sales factor apportionment. Additionally, temporary limitations on the use of tax credits and net operating losses that were enacted in 2008 and 2010 have ended as of the 2010 and 2012 tax years respectively.

Insurance Tax

The insurance tax forecast has been increased by $106 million in the current year and decreased by $90 million in the budget year. The revenue changes are due in large part to a delay in refunds associated with a previous Board of Equalization decision on the accounting method used by insurers.

Other Revenues and Transfers

The May Revision reflects a $56.7 million increase in current year receipts from unclaimed property. The $56.7 million consists of increased receipts in December 2011, coupled with decreased payments for claims for the same period, as compared to the estimates in the Governor's Budget. Including the unclaimed property revenue increase, the May Revision includes $21 million in minor revenue solutions for 2011-12 and $128 million for 2012-13. The May Revision proposes an increase in loan and transfer budget solutions of $367 million in 2011-12 and $673 million in 2012-13, which includes new transfers and extensions of repayment dates for loans. In total, the May Revision includes $395 million in loan and transfer solutions for 2011-12 and $2 billion for 2012-13.

2011 Realignment Revenues

The 2011 Realignment is funded by a portion of the SUT rate as well as by a portion of the Vehicle License Fee (VLF). The May Revision forecasts that the 1.0625% of the SUT rate that is dedicated to the 2011 Local Revenue Fund will contribute $5.2 billion in 2011-12 and $5.4 billion in 2012-13. The 2011 Realignment portion of the VLF is estimated at $462 million for 2011-12 and $496 million for 2012-13. The sales tax estimates are increased by $46 million in 2011-12 and $115 million in 2012-13 above the Governor's Budget levels.

Property Tax

Article XIIIA of the State Constitution (Proposition 13) provides that property is assessed at its 1975 fair market value until it changes ownership. When ownership changes, the assessed value is redetermined based on the property's current market value. New construction is assessed at fair market value when construction is completed. A property's base year value may be increased by an inflation factor, not to exceed 2 percent annually.

Although the property tax is a local revenue source, the amount of property tax generated each year has a substantial impact on the state budget because local property tax revenues allocated to K-14 schools typically offset General Fund expenditures. Assessed value growth is estimated based on twice-yearly surveys of county assessors and evaluation of real estate trends. Declines in sales volumes and prices in 2010, coupled with declines in property values and failures to remit property tax payments as a result of mortgage defaults and foreclosures, negatively impacted assessed values and property tax levies in 2011-12 to an extent that was greater than anticipated at Governor's Budget. While those trends moderated somewhat in 2011, the declines in sales volumes and prices were still significant enough to reduce the estimated 2012-13 growth rate from the level estimated in the fall. Property tax collections are estimated to decrease 0.4 percent from 2010-11 to 2011-12, which is a decline from the positive 0.5 percent growth rate forecast at Governor's Budget. The 2012-13 property tax growth rate is estimated at 0.5 percent, which is down from the 0.7 percent estimated in the fall.

K thru 12 Education

The May Revision includes total funding of $67.5 billion ($38.2 billion General Fund and $29.3 billion other funds) for all K-12 Education programs.

Proposition 98

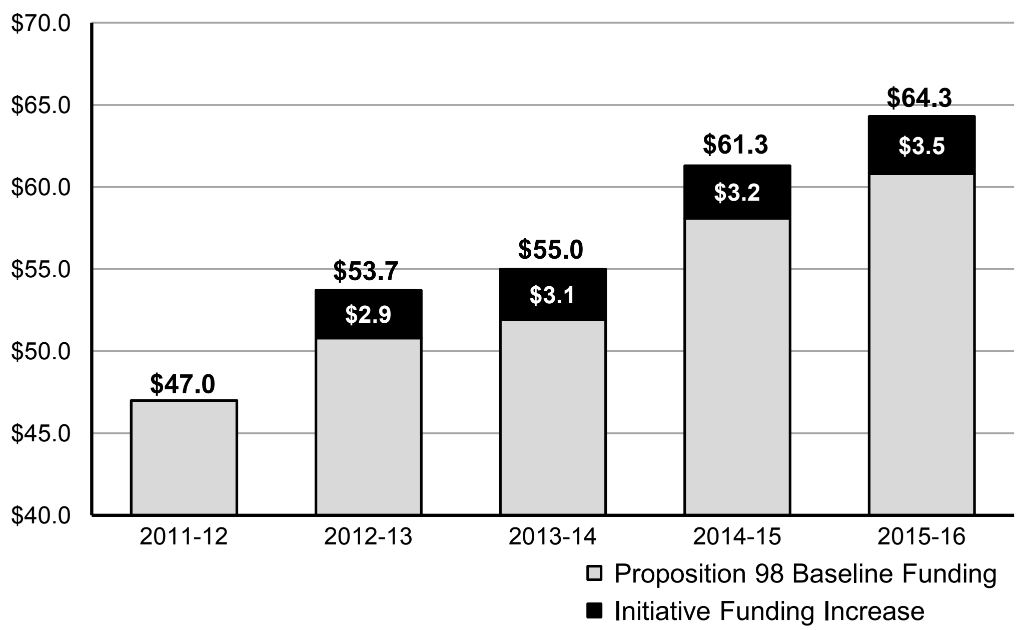
A voter-approved constitutional amendment, Proposition 98, guarantees minimum funding levels for K-12 schools and community colleges. The guarantee, which went into effect in the 1988-89 fiscal year, determines funding levels according to multiple factors including the level of funding in 1986-87, General Fund revenues, per capita personal income and school attendance growth or decline.

The May Revision continues to address the several most significant issues facing schools. Over time, it restores the $9.6 billion in reductions that have been made to Proposition 98 funding since 2007-08, reduces the "wall of debt" by eliminating deferrals, and restores the deficit factor reductions to general purpose school revenue limit funding in the same manner in which the reductions were made. The May Revision will increase funding to schools by more than $15 billion over four years, an increase of over $2,500 per pupil. After restoring cuts to revenue limits, increased funds will be allocated based on students' needs. The May Revision also replaces the current complex, administratively costly and imbalanced school finance system with a simpler, more transparent funding formula that removes the various spending restrictions that prevent schools from effectively and efficiently managing their funds based on local educational priorities.

For 2012-13, the Proposition 98 Guarantee is $53.7 billion. Although revenues are, in aggregate, down from the Governor's Budget level in both years, the difference between 2011-12 and 2012-13 is larger than it was in the Governor's Budget and this results in a $1.2 billion higher calculation for the Proposition 98 minimum guarantee. The May Revision proposes to maintain level Proposition 98 funding for every school district, reduce the "wall of debt" by reducing the payments to schools that are deferred each year from $10.4 billion to $7.6 billion, and to fund the Quality Education Investment Act (QEIA) program within the Proposition 98 guarantee.

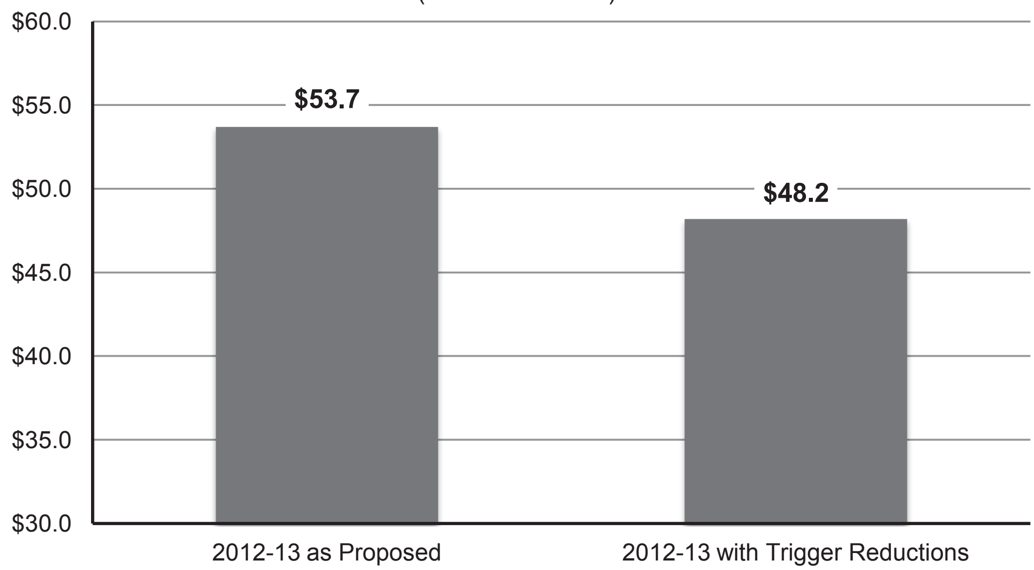
The May Revision assumes passage of the Governor's tax initiative, which increases Proposition 98 funding by $2.9 billion in 2012-13. This builds on the Governor's Budget proposal to begin restoring the significant reductions imposed on K-12 schools and community colleges since 2007-08. In 2013-14, more than $4 billion in additional funding will be available for allocation to schools, of which half will fund COLA and restore the deficit factor reduction to general purpose revenue limit funding and the other half will further reduce the payment deferrals. By 2015-16, Proposition 98 is projected to grow by more than $17 billion higher than the 2011-12 level, the payment deferrals will have been fully restored, and the deficit factor reductions will be close to fully restored. (See Figure K12-01).

Figure K12-01
K-14 Funding Increases by $17 Billion Over 4 Years
(Dollars in billions)



The May Revision outlines the reductions that would be necessary to restore balance if the November initiative is not approved by the voters. Specifically, $5.5 billion in reductions to schools would be triggered in 2012-13. A reduction of this magnitude would result in a funding decrease equivalent to the cost of three weeks of instruction. It will also continue to provide 20 percent of program funds a year in arrears. (See Figure K12-02).

Figure K12-02
Proposition 98 as Proposed and with Trigger Reductions
2012-13 May Revision
(Dollars in Billions)



The May Revision continues to provide significant and permanent additional flexibility to schools by consolidating the vast majority of categorical programs and revenue limit funding into a weighted student formula that provides funding to schools based on the needs of their students. The new funding formula will ensure that the billions in additional funding schools will receive within the next few years can be used for locally determined priorities. In addition, the existing deficit factor reductions to revenue limits will be restored before the formula is fully implemented and COLAs will be provided on both revenue limits and the new formula. As structured, this proposal holds school districts harmless next year, fully restores cuts to revenue limits, and distributes increased funds based on the needs of students.

The sections that follow provide an overview of K-12 funding adjustments, while the Higher Education section contains the Proposition 98 adjustments for the Community Colleges.

K-12 Budget Adjustments

Proposals to Balance the Budget:

- *Redevelopment Agency Asset Liquidation*—An increase of $1.2 billion in offsetting local property taxes for 2012-13 to reflect the distribution of cash assets previously held by redevelopment agencies. The increase in local revenue reduces Proposition 98 General Fund by an identical amount. An additional $90.9 million in property tax funds will be retained by school districts and county offices of education.
- *Proposition 98 Adjustments*—A decrease of $558.6 million, reflecting the elimination of the hold-harmless adjustment provided to schools from the elimination of the sales tax on gasoline in 2010-11, maintaining the rebenching methodology used in the 2011 Budget Act for mental health services for children and Child Care, and using the traditional "1986-87 look back methodology" for the ongoing shift of Redevelopment Agency property tax revenues to schools. The May Revision also redesignates a $785.3 million overappropration of the guarantee in 2011-12 towards existing settle up debt owed to schools and the *California Teachers Association v. Schwarzenegger* settlement agreement payment requirement for 2012-13. The cumulative effect of these changes is $931.8 million in Proposition 98 savings for 2012-13.
- *Quality Education Investment Act*—A decrease of $450 million General Fund for 2012-13. The overappropriation in 2011-12 will be used prepay the $450 million required to be provided on top of the minimum guarantee in 2012-13 pursuant to the *California Teachers Association v.Schwarzenegger* settlement agreement. The program will be funded within the guarantee to achieve one-time savings of $450 million for 2012-13.

Other Significant Adjustments:

- *K-12 Deferrals*—An increase of $392.9 million Proposition 98 General Fund, for a total of $2.6 billion, to reduce inter-year budgetary deferrals from $9.5 billion to $6.9 billion.
- *Transitional Kindergarten*—A decrease of $132.2 million in projected savings associated with the proposed elimination of transitional kindergarten requirements. The projected erosion in savings is attributable to anticipated declining enrollment costs as well as an expected increase in two-year kindergarten costs. The remaining projected savings of $91.5 million from the elimination of transitional kindergarten requirements will be used to restore reductions to Preschool included in the Governor's Budget and support the expansion of preschool enrollment as discussed in the Child Care section below.
- *Charter Schools*—An increase of $3.4 million Proposition 98 General Fund for charter school categorical programs due to charter school growth.
- *Local Property Tax Adjustments*—An increase of $459 million in 2011-12 and an increase of $398 million in 2012-13 for school district and county office of education revenue limits as a result of lower offsetting property tax revenues.
- *Average Daily Attendance (ADA)*—An increase of $122 million in 2011-12 and an increase of $169 million in 2012-13 for school district and county office of education revenue limits as a result of an increase projected ADA in both years.

Ballot Trigger Reductions:

- If new revenues are not achieved, the potential trigger reduction for K-14 programs is $5.5 billion, an increase of $656.7 million over the $4.8 billion trigger reduction proposed at the Governor's Budget. If this trigger reduction is implemented, the $2.8 billion repayment of deferrals in 2012-13 will not occur. The remaining $2.7 billion will be a reduction in programmatic funding for schools. Schools will be provided flexibility to reduce the school year by a combined total of 15 days in 2012-13 and 2013-14. This will allow schools to use a combination of reserves, reductions in the school year and other savings options to absorb this cut over a two year period.

Significant Other General Fund Policy Issues:

- *Weighted Pupil Funding Formula*—The Governor's Budget proposed implementing a weighted student funding formula to replace California's complex, administratively costly and imbalanced school finance system. The Governor's Budget also proposed that school districts and charter schools receive significant and permanent flexibility to expend the majority of their educational funds on any locally determined educational purpose. The May Revision addresses concerns raised by the Education community with the following modifications to the proposed weighted student funding formula:
    - *Increase the Base Grant to the Revenue Limit Level*—The base grant portion of the weighted student formula will be approximately $5,421, instead of the $4,920 level proposed in the Governor's Budget. This will set the base grant portion of the weighted student formula equal to, or slightly higher, than the current average revenue limit for unified school districts (which is $5,203). In addition, COLAs will be provided on both revenue limits and the new formula.
    - *Repay Deficit Factor*—The proposal will require that the existing deficit factor reduction to revenue limits be restored before the weighted student formula is fully implemented. Also, the phase in period is increased from five years to seven years. Further, implementation will be contingent on school funding being at the levels proposed in the May Revision.
    - *Add Grade Span Adjustments*—Base grants, supplemental grants, and concentration grants are revised to provide grade span differentials to reflect the cost of educating students in grades K-3, 4-6, 7-8 and 9-12, respectively.
    - *Supplemental and Concentration Grant Weights*—School districts and charter schools will receive a supplemental grant factor equal to 20 percent of the base grant for low-income and English learner students, with concentration grants adjusted accordingly. The concentration grant factor for charter schools will be capped at the districtwide average. In addition, school districts will be required to spend the funding provided by the supplemental and concentration grants for the benefit of the low-income and English learner students for which the district received the funding.
    - *Fund Add On Programs*—The current Home-To-School Transportation and Targeted Instructional Improvement Grant program funding formula allocations

are continued as weighted student formula "add-on" programs. However, the funding will be flexible.

- *Make Contingent on Accountability System Changes*—Continued phase-in of the formula in 2013-14 will be contingent on legislation identifying additional indicators of district and school success such as professional development opportunities for teachers, college enrollment and employment rates for students, and provision of the necessary conditions for learning, which would be linked to incentive funding.

- *Mandates Block Grant*—The Governor's Budget proposed to eliminate nearly half of the existing K-12 and community college mandates and provide $200 million to fund a mandates block grant incentive program to reimburse K-12 schools and community colleges for all remaining mandated activities. The May Revision proposes the following changes to the block grant program:

  - *Distribute Funding Equally on a Per-Student Basis*—The block grant would distribute funding to school districts, county offices of education, charter schools, and community colleges equally based on average daily attendance for K-12 schools and funded full-time equivalent students for community colleges. Of the $200 million proposed for the block grant, $166.6 million would be available for K-12 schools and $33.4 million would be available for community colleges, providing a uniform funding rate of approximately $28 per student.

  - *Eliminate the Existing Mandates Claiming Process*—The existing claiming process would be eliminated as an option for K-12 schools and community colleges to seek reimbursement for the mandates funded in the block grant. Eliminating this option will ensure that K-12 schools and community colleges are reimbursed at the same rate for performing the same mandated activities.

  - *Repeal High-Cost Mandates*—The six highest cost mandates would be permanently repealed. These programs include Graduation Requirements (Second Science Course), Behavioral Intervention Plans; Habitual Truants; Notification of Truancy; Notification to Teachers and Pupil Discipline Records; and Pupil Suspensions, Expulsions, and Expulsion Appeals. The remaining mandates slated for elimination will be suspended in 2012-13 until subsequent legislation is introduced to permanently repeal those activities.

- *Charter School Reforms*—Charter schools receive less per average daily attendance funding than traditional public schools and are not eligible for reimbursement of state-mandated costs. In addition, they have limited access to educational facilities, limited options for borrowing funds at affordable interest rates and cannot issue bonds. The May Revision proposes the following modifications to the charter school trailer bill legislation included in the Governor's Budget:

- *Allow Surplus Property Conveyance Under Specific Conditions*—The Governor's Budget proposed requiring school districts to convey surplus property to any charter school opting to claim that property. It also provided school districts with an incentive to sell property to charter schools without having to declare the property surplus and without losing eligibility for the school facilities program. The May Revision limits the surplus property conveyance requirement to facilities with an educational purpose that were purchased with state funds.

- *Eliminate the State Funding Determination Process for Non-Classroom-Based Charters*—The Governor's Budget proposed to allow all new and existing non-classroom-based charter schools to receive full funding without needing State Board of Education review and approval. The proposal continues to eliminate the State Board of Education funding determination process, but will grandfather in the existing funding levels for all non-classroom-based charter schools, including those currently receiving a reduced funding level. Non-classroom-based charter schools currently receiving a reduced funding level will only be allowed to receive full funding upon renewal of their charter after 2012-13. This is a cost-neutral modification that will remove an overly burdensome and unnecessary process at the state level.

- *Increase Financial Assistance to Charters*—County treasurers will be authorized to lend to charter schools. Also charter schools, as a condition of directly applying to the state for a deferral exemption, will be required to provide a copy of their application for a deferral exemption to their charter authorizer.

Child Care and State Preschool

Subsidized Child Care includes a variety of programs that are designed to support low-income families so they may remain gainfully employed. These programs are primarily administered by the State Department of Education (SDE) through non-Proposition 98 funding and the annual federal Child Care and Development Fund (CCDF) grant. Additionally, part-day preschool programs, funded through Proposition 98, meet a child care need, but are also designed as an educational program to help ensure children develop the skills needed for success in school. The SDE and the Department of Social Services (DSS) also jointly administer the three-stage CalWORKs child care system to meet the needs for child care of recipients of aid while they participate in work activities and as they transition off of cash aid. Families can access services through centers that contract directly with the SDE (Title 5 centers), or by receiving vouchers from county welfare departments or alternative payment program providers.

Proposals to Balance the Budget:

- *Reduce Child Care Costs:* The May Revision reflects total child care savings of $452.5 million in Non-Proposition 98 General Fund (including CalWORKs Stage 1 funded in the DSS budget), and the elimination of 29,600 child care slots. The Governor's Budget proposed a decrease of $452.2 million and the elimination of 54,800 slots to align eligibility and need criteria for low-income working family child care services with federal income eligibility rules and welfare-to-work participation requirements, consistent with the Administration's proposal to restructure CalWORKs, and to reduce reimbursement rates. Concerns were raised that by eliminating child care services for non-cash-aided families who are engaged in education or training, families will not be able to achieve their employment goals. The May Revision proposes the following major adjustments to address these concerns, while maintaining the level of savings reflected in the Governor's Budget.
    - *Allow Families Engaged in Education or Training to Receive Child Care Services*—An increase of $180.1 million to allow families who are engaged in education or training to receive child care services on that basis for up to two years.
    - *Reduce Reimbursement Rates for Voucher-Based Programs*—A decrease of $184.2 million by reducing reimbursement rate ceilings for licensed voucher-based providers from the 85^{th} percentile to the 40^{th} percentile of the private pay market, based on the 2005 Regional Market Rate (RMR) survey data. License-exempt providers will be reimbursed based upon 71 percent of the lowered licensed ceilings.

Significant Adjustments:

- *Restructure Administration of Child Care:* The Governor's Budget proposed to shift the eligibility and payment functions for child care services from the alternative payment programs and Title 5 centers to the county welfare departments, beginning in 2013-14. All eligible families, including those currently enrolled in Title 5 centers, will receive a voucher for payment to a provider of their own choice. Concerns were raised that shifting to a voucher-only child care system administered by the counties will reduce access to higher quality Title 5 centers. In addition, concerns were raised that non-cash-aided families will not be able to access services because funding associated with child care services will be capped at the appropriation level and prioritized for cash-aided families. The May Revision proposes the following policy changes to address these concerns:

- *Establish a County Child Care Block Grant*—A child care block grant will be created, separate from the county single allocation, to ensure that eligible low-income working families can continue to access child care services.

- *Preserve Title 5 Center Infrastructure*—County welfare departments will contract with Title 5 centers, based on the allocation of Title 5 center slots in 2012-13, as a condition of receiving child care block grant funds. Counties will be provided flexibility to deviate from this allocation up to 10 percent. After a specified period of time, counties will be allowed to reallocate Title 5 center slots to voucher-based providers within the county to align service needs with available resources. A Title 5 center will be required to maintain its designation through SDE, primarily through submitting an annual assessment of its educational program.

- *Facilitate Transition of Child Care Services to County Welfare Departments*—Some funding will be shifted from SDE to DSS to fund state operations costs associated with the transition of child care services to the county welfare departments, and to enable counties that are prepared to assume responsibility for these services to implement the transition in 2012-13.

- *State Plan for Quality Activities*—The DSS will develop a plan in 2012-13, in consultation with SDE, that outlines the quality activities to be funded in 2013-14. The plan would require that DSS conduct quality activities to promote the health and safety of children in care, and that SDE conduct activities to promote early learning and readiness for school. The plan would also reflect an allocation to county welfare departments to target quality funds to local needs and priorities.

- *Part-Day Preschool Programs:* The May Revision redirects $91.5 million in savings from the proposed elimination of transitional kindergarten to: (1) restore the 10-percent reduction to the Standard Reimbursement Rate for part-day preschool programs included in the Governor's Budget ($34.1 million), and (2) to expand access to part-day preschool for 15,500 children from low-income families ($57.5 million).

Higher Education

Higher Education includes the University of California (UC), the California State University (CSU), the California Community Colleges, the California Student Aid Commission (CSAC) and several other entities.

The May Revision builds upon the long-term vision for higher education in the Governor's Budget. This vision is rooted in the belief that higher education should be affordable and student success can be improved. The significant components include the following:

- Affordability—The objective is to curtail tuition and fee increases and to lessen the pressure for students to take out burdensome loans.
- Student Success—The state will make annual General Fund augmentations contingent upon each institution achieving the Administration's priorities, including improvements in specific accountability metrics.
- Stable Funding Source—The state will increase its General Fund contribution to each institution's prior-year base, contingent upon the passage of the Governor's tax initiative.
- Fiscal Incentives—The shift of retirement costs and bond debt service appropriations into each institution's budget will encourage the institutions to factor these costs into their overall fiscal outlook and decision-making process.

The May Revision includes total funding of $23 billion ($11.6 billion General Fund and $11.4 billion other funds) for all programs included in these agencies.

University of California

Drawing from the top 12.5 percent of the state's high school graduates, 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 and partners with private industry to manage two others. UC also and operates five medical centers that support the clinical teaching programs of the UC's medical and health sciences schools that handle more than 3.8 million patient visits each year.

Proposal to Balance the Budget:

- *Partial Delay of Operating Budget Needs*—A decrease of $38 million to the $90 million augmentation included in the Governor's Budget for base operating costs that could be used to address costs related to UC's retirement program contributions or other needs. This revised proposal will provide $52 million in 2012-13, which matches the Governor's Budget augmentation for CSU retirement contributions, and delays the remaining $38 million augmentation until 2013-14.

California State University

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, CSU provides undergraduate degrees in a broad range of disciplines 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. The CSU has 23 campuses and approximately 426,400 students. The CSU grants more than one-half of the state's bachelor's degrees and one-third of the state's master's degrees. It also produces over 50 percent of California's teachers.

Significant Adjustments:

- *Continue to Provide Adjustments for Retirement Costs*—The Governor's Budget proposed that CSU no longer receive annual budget adjustments for CSU's retirement costs beginning in 2013-14. However, recognizing that certain costs are determined by California Public Employees' Retirement System over which CSU has no control, the May Revision modifies that proposal so that CSU will receive annual budget adjustments associated with the unfunded liability portion of its retirement costs, as outlined by CalPERS. The May Revision will also adjust CSU's base budget to reflect incremental changes for 2012-13 employer contribution rates.

- *Provide CSU the Authority to Negotiate and Set Employee Health Benefits with Represented and Non-Represented Employees*—The Administration proposes trailer bill language that will provide CSU the same statutory authority to negotiate or set employee health care benefits that is provided to the Department of Personnel Administration (DPA) in setting such policies for other state employees. Currently, CSU pays 100 percent of the health care premiums for its employees and 90 percent for employees' family members. For most state employees, the state pays either 80 or 85 percent of employees' health care premiums and 80 percent for family members. State law specifies contribution rates for state and CSU employer payments for employee health care premiums. In 1991, state law provided DPA the ability to negotiate employer shares for health benefits for state employees, but a similar statutory change was not provided to CSU. This proposal will provide CSU a tool to better manage and negotiate the entirety of its personnel costs.

California Community Colleges

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

Significant Adjustments:

- *Mandates Block Grant*—The Governor's Budget proposed to eliminate nearly half of the existing K-14 mandates and provide $200 million to fund a mandates block grant incentive program to reimburse K-12 schools and community colleges for all remaining mandated activities. The May Revision proposes the following changes to the block grant program:

- *Distribute Funding Equally on a Per-Student Basis*—The May Revision proposes to distribute block grant funding to school districts, county offices of education, charter schools, and community colleges equally based on average daily attendance for K-12 schools and funded full-time equivalent students for community colleges. Of the $200 million proposed for the block grant, $166.6 million would be available for K-12 schools and $33.4 million would be available for community colleges, providing a uniform funding rate of approximately $28 per student.

- *Eliminate the Existing Mandates Claiming Process*—The proposal eliminates the claiming process as an option for K-12 schools and community colleges to seek reimbursement for the mandates funded in the block grant. Eliminating this option will ensure that K-12 schools and community colleges are reimbursed at the same rate for performing the same mandated activities.

- *Add Mandates to Block Grant and Suspension List*—The Commission on State Mandates recently determined that significant portions of the Minimum Conditions for State Aid, Community College Construction, and Discrimination Complaint Procedures test claims contained reimbursable state-mandated activities. The May Revision proposes to add the Minimum Conditions for State Aid and Community College Construction mandates to the list of eligible mandates to be funded from the block grant while the state reviews the policy and fiscal implications. Additionally, the May Revision proposes to suspend the Discrimination Complaint Procedures mandate because nearly all of these mandated activities are based on regulations issued by the Board of Governors of the California Community Colleges. These actions would save millions of dollars in Proposition 98 General Fund.

- *Apportionment Adjustments*—An increase of $30.8 million in 2011-12 and a net decrease of $238.9 million Proposition 98 General Fund in 2012-13 to apportionment funding. Specific adjustments include:

    - An increase of $30.8 million in 2011-12 to reflect a decrease in estimated local property tax revenues.

    - A decrease of $191.2 million in 2012-13 to reflect an increase in estimated local property tax revenues largely due to the recovery of cash assets held by redevelopment agencies.

  - A decrease of $125.4 million in 2012-13 to reflect an increase in estimated Education Protection Act revenues.
  - An increase of $95.1 million in 2012-13 to reflect the restoration of apportionment funding previously deferred.
  - A decrease of $15 million in 2012-13 to reflect an increase in estimated student fee revenues due to the recent policy change by the Board of Governors of the California Community Colleges to increase the need threshold for Part C fee waiver eligibility from $1 to $1,104.
  - A decrease of $2.4 million in 2012-13 to reflect an increase in estimated oil and mineral revenues.

- *Quality Education Investment Act*—Of the previously discussed $450 million in 2012-13 Quality Education Investment Act funding, $48 million is associated with the Community Colleges.
- *Redevelopment Agency Revenue*—a decrease of $30.8 million in 2011-12 from the Governor's Budget of $146.9 million to the May Revision of $116.1 million to reflect revised estimated revenue from the elimination of redevelopment agencies. A corresponding $116.1 million reduction to apportionment funding is reflected as General Fund savings for 2011-12. An increase of $190.6 million in 2012-13 for a total of $341.2 million. The increase largely reflects the recovery of one-time liquid assets totaling $200.9 million and a $10.3 million decrease in estimated ongoing revenues from $150.6 million to $140.3 million. An additional $16 million in property tax funds will be retained by community college districts.

California Student Aid Commission

CSAC administers state financial aid to students attending all institutions of public and private postsecondary education through a variety of programs including the Cal Grant High School and Community College Transfer Entitlement programs, the Competitive Cal Grant program, and the Assumption Program of Loans for Education. Over 91,000 students received new Cal Grant awards, and over 144,000 students received renewal awards in 2010-11.

Prior to 2001, the program offered a capped number of awards to students and award amounts were specified in the Budget. Under that construct, the program supported 130,000 students at a cost of $462 million in 2000-01. The program is now an entitlement and has been one of the fastest growing programs in the state. Costs have increased due to an increased number of students participating in the program and UC and CSU tuition increases. The number of students in the program increased to an estimated 259,000 and costs increased to $1.6 billion.

The May Revision builds upon the Governor's Budget proposals to focus financial aid on students attending the state's public higher education institutions and other institutions that are able to minimize student debt loads and produce successful graduates, students demonstrating a high likelihood of completing their degrees or programs, and students demonstrating the greatest financial need.

Proposals to Balance the Budget:

- *Align Cal Grant Program Award Methodology with Federal Pell Grant Methodology* —The Administration proposes trailer bill language to align the methodology for determining award levels to the federal Pell Grant award methodology. Currently, a Cal Grant applicant who meets academic, income, and asset requirements is eligible for an award equal to the full tuition cost at UC and CSU or an award amount specified in the annual Budget Act for private, for-profit and non-profit institutions. This results in an "all-or-nothing" award determination. In contrast, the Pell Grant award is tailored to the financial need of each student and factors in family income, the cost of attendance, and the expected family contribution. Under this proposal, the neediest students would continue to receive maximum award amounts (approximately 63 percent of Cal Grant recipients) while students with lower costs of attendance and/or higher family incomes will receive a reduced Cal Grant award that would mirror the Pell Grant award. This proposal will not affect existing Cal Grant recipients and will only apply to students who apply for grants after July 2012.

- *Restrict Cal Grant Program Participation to Institutions that Meet a New Graduation Rate Standard*—A decrease of $38.4 million in 2012-13 to reflect: (1) a reduction in the maximum student loan cohort default rate allowable by a participating Cal Grant institution from 30 percent to 15 percent; and (2) a 30-percent minimum graduation rate standard for all participating Cal Grant institutions. The 15-percent loan default rate will replace the Governor's Budget proposal to reduce the loan default rate from 30 percent to 24.6 percent. Cohort default rates measure the percentage of an institution's borrowers who, upon entering student loan repayment, default within three years. Any institution that exceeds the loan default rate or drops below the graduation rate will be prohibited from participating in the Cal Grant program for one academic year. These requirements will not apply to any institution with 40 percent or fewer of their students borrowing federal student loans to attend college, such as community colleges.

- *Offset Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements*—A decrease of $67.4 million in 2012-13 to reflect TANF funds available through an interagency agreement with the Department of Social Services pursuant to CalWORKs adjustments and reductions. Combined with the TANF funds included in the Governor's Budget, the May Revision offsets $803.8 million in Cal Grant General Fund costs.
- *Offset Cal Grant Costs with Student Loan Operating Fund (SLOF)*—An increase of $30 million SLOF and a like amount decrease of General Fund in 2012-13 to reflect the availability of SLOF funds to offset Cal Grant program General Fund costs. Combined with the SLOF funds included in the Governor's Budget, the May Revision offsets $60 million in Cal Grant General Fund costs.

Other Significant Adjustments:

- *Movement of Students Between Cal Grant B and Cal Grant A Awards*—An increase of $27.7 million General Fund in 2011-12 and an increase of $26.5 million General Fund in 2012-13 to allow students within the Cal Grant B program to switch to the Cal Grant A program when renewing their award. Some students initially qualify for both awards. Students that elect to receive a Cal Grant B instead of a Cal Grant A are held to a significantly lower income ceiling for the entirety of their program eligibility. Due to new income verification requirements adopted last year, a portion of renewal Cal Grant B students have become ineligible for the program because of the type of award they chose. As a result, the Administration proposes to allow only those Cal Grant B students who were originally eligible for both a Cal Grant A and a Cal Grant B award and are later deemed ineligible to renew their Cal Grant B due to a change of family income to renew as Cal Grant A students.
- *New Cal Grant Costs Due to California State University Tuition Increases*—An increase of $31.2 million General Fund in 2012-13 as a result of a 9.1-percent tuition increase at CSU for the 2012-13 academic year. Because state law provides Cal Grant awards to CSU students that cover the cost of tuition, this tuition increase will result in an increase in Cal Grant program costs.

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Health and Human Services

The Health and Human Services Agency oversees departments and other state entities such as boards, commissions, councils, and offices that provide health and social services to California's vulnerable and at-risk residents.

The May Revision includes total funding of $103.9 billion ($25.9 billion General Fund and $78 billion other funds) for all programs overseen by this Agency.

Department of Health Care Services

Medi-Cal, California's Medicaid program, is administered by the Department of Health Care Services (DHCS). Medi-Cal is a public health insurance program that provides comprehensive health care services at no or low cost for low-income individuals including families with children, seniors, persons with disabilities, foster care children, and pregnant women. The federal government dictates a mandatory set of basic services including, but not limited to, physician services, family nurse practitioner services, nursing facility services, hospital inpatient and outpatient services, laboratory and radiology services, family planning, and early and periodic screening, diagnosis, and treatment services for children. In addition to these mandatory services, the state provides optional benefits such as outpatient drugs, home- and community-based waiver services, and medical equipment, which avoid more costly services.

Proposals to Balance the Budget:

- *Coordinated Care Initiative*—The Governor's Budget proposed a Coordinated Care Initiative (CCI) to integrate care for individuals who are eligible for both Medi-Cal and Medicare. This initiative proposed to have the same health plan responsible for the delivery of all benefits by combining the full continuum of acute, primary, institutional, and home-and community-based services for dual eligible beneficiaries into a single benefit package over three years beginning January 1, 2013. Medi-Cal long-term care benefits were to be integrated in the first year. The Budget assumed that Medicare savings from this integration would be shared equally with the federal government. It also assumed decreased utilization of more expensive services including nursing home stays and hospitalization by increasing utilization of home and community-based services such as In-Home Supportive Services (IHSS). Lastly, the Budget included a payment deferral (one payment for all providers) to accelerate the savings in 2012-13.

  The May Revision proposes to phase in the long-term care benefits as each county transitions into managed care. Other changes include reducing the number of counties in phase one from ten to eight, and delaying the start date from January 1, 2013 to March 1, 2013. Counties will continue their role in assessing and authorizing hours for the IHSS program. In addition, consumers will continue to select and direct their provider. The proposal includes a county-specific maintenance of effort to hold county expenditures to the estimated level that would have been incurred absent the CCI. As CCI is implemented and funding responsibility is shifted to the state, collective bargaining will eventually transition to the state. As modified, the proposal saves $663.3 million in 2012-13 and $887 million when fully implemented. Implementation is contingent on securing a six-month stable enrollment period and 50 percent of total savings from the federal government.

Additionally, the May Revision includes several hospital and nursing home payment savings proposals. The Medi-Cal program currently spends approximately $15 billion ($3.4 billion General Fund) on hospitals and over $4 billion ($2 billion General Fund) on nursing homes. Together these costs comprise nearly 35 percent of total Medi-Cal General Fund expenditures. The May Revision proposes the following:

- *Hospital Payment Changes*—The May Revision proposes to reduce supplemental payments to private hospitals, eliminate public hospital grants, and eliminate increases to managed care plans for supplemental payments to designated public hospitals for savings of $150 million in General Fund in 2012-13 and $75 million in

2013-14. In addition, the May Revision proposes to delay the transition to a new diagnosis-related group-based payment methodology for hospitals by six months (from January 1, 2013 to July 1, 2013).

- *Unexpended Federal Waiver Funds*—Designated public hospitals and the state provide care to individuals who are uninsured and who are not eligible for full-scope Medi-Cal benefits. The Medi-Cal 1115 Bridge to Reform Waiver allows the state and designated public hospitals to access over $750 million in federal funds for providing care to these individuals. Additionally, unexpended prior year waiver funds can be rolled over to provide additional federal funding. The May Revision proposes that the additional funds be split equally between the state and the designated public hospitals, rather than the funding being provided exclusively to these hospitals for General Fund savings of $100 million in 2012-13 and $9 million in 2013-14.

- *Non-Designated Public Hospital Payment Changes*—The Medi-Cal program uses various payment methodologies to reimburse private hospitals and designated and non-designated public hospitals. Although non-designated public hospitals are publicly owned and operated, they have historically been funded similar to private hospitals, with Medi-Cal payments consisting of 50 percent General Fund and 50 percent federal funds. In contrast, designated public hospitals receive no state General Fund for their inpatient Medi-Cal fee-for-service and instead use their own funds to draw down federal funds. This proposal would align non-designated public hospital Medi-Cal funding with the designated public hospital funding methodology for inpatient Medi-Cal fee-for-service. This change would result in approximately $75 million in General Fund savings in 2012-13 and ongoing. To minimize the financial impact on the non-designated public hospitals, the department will seek increased federal funding for these hospitals.

- *Nursing Homes*—Existing law authorizes a cumulative 2.4-percent rate increase for nursing homes in 2011-12 and 2012-13. The rate increase is funded with from fee revenues. This proposal would rescind the 2012-13 rate increase (estimated at about 2 percent) and continue the maximum amount of fee revenue collection, and retain fee revenue for a General Fund benefit of $47.6 million. Existing law also requires DHCS to set-aside 1 percent of nursing home payments for supplemental payments based on quality measures. This proposal would retain the 1-percent set-aside for a General Fund benefit of $23.3 million.

- *Proposition 10 Funding*—This proposal reflects $40 million to be provided by the First 5 California Children and Families Commission for programs serving children ages birth through five. This would decrease Medi-Cal General Fund by $40 million.

Other Significant Adjustments:

- *Decreased Caseload Projections for Medi-Cal Base*—A decrease of approximately $200 million General Fund in 2011-12 and $700 million General Fund in 2012-13 as compared to the previous budget forecast.

- *Implementing Provider Payment Reductions*—An increase of $245.5 million in 2011-12 and $174.6 million in 2012-13 as a result of court rulings preventing the implementation of payment reductions. The May Revision continues to set-aside funds in the event litigation challenging recently approved provider rate reductions is successful.

- *Implementing Copayments*—An increase of $555.3 million in 2012-13 because the federal government rejected the proposal to implement various copayments for Medi-Cal beneficiaries. The May Revision assumes copayments of $15 for non-emergency room visits and $1 and $3 copayments for pharmacy based on the drug status and how medications are dispensed to achieve savings of $20.2 million General Fund in 2012-13.

Managed Risk Medical Insurance Board

The Managed Risk Medical Insurance Board administers five programs that provide health coverage through commercial health plans, local initiatives and county organized health systems to certain persons who do not have health insurance. The five programs include the Access for Infants and Mothers Program, the Healthy Families Program, the County Health Initiative Matching Fund Program, the Major Risk Medical Insurance Program, and the Pre-Existing Conditions Insurance Plan Program. Only the Healthy Families Program is funded with General Fund.

Proposal to Balance the Budget:

- *Healthy Families*—The Governor's Budget proposed to reduce Healthy Families managed care rates to the same level that it would cost to cover these children under Medi-Cal and to transfer Healthy Families Program beneficiaries to Medi-Cal over a nine-month period beginning in October 2012. The proposal assumed savings of $64.4 million. The May Revision maintains this proposal but reflects savings of $48.6 million. This decrease is primarily attributable to revising the per-member per-month average cost of a Medi-Cal beneficiary from $76.86 to $83.91. This new rate includes additional Medi-Cal administrative costs and accounts for mental health benefits that are carved out of the Medi-Cal managed care rate.

Other Significant Adjustments:

- *Healthy Families Program Base Estimate Adjustment*—An increase of $5.7 million in 2011-12 and $9.5 million in 2012-13 compared to base costs included in the Governor's Budget. These increases are primarily due to a shift in enrollment from lower-cost to higher-cost plans.
- *Implementing Premium and Copayment Increases*—An increase of $42.4 million due to the elimination of savings previously assumed for premium and copayment increases as the federal government has denied this request.

Department of Social Services

The Department of Social Services administers programs that provide services and assistance payments to needy and vulnerable children and adults in ways that strengthen and preserve families, encourage personal responsibility, and foster independence.

Proposals to Balance the Budget:

- *CalWORKs Redesign and Refocus*—The Governor's Budget proposed a major restructuring of the CalWORKs program to refocus on welfare-to-work. The main components of the proposal included: (1) reducing the time limit for adult recipients from 48 months to 24 months if sufficient hours of paid employment are not secured within the first two years on aid, (2) retroactively applying months during which the adult recipient was exempt from welfare-to-work participation requirements or sanctioned towards his or her 24-month time limit, (3) providing additional fiscal incentives for families that secure sufficient hours of paid employment, and (4) creating a separate Child Maintenance program with lower monthly grants for families that do not secure sufficient hours of paid employment after 24 months on aid and for families in sanction status over 3 months.

  The May Revision reflects several policy changes, including: (1) allowing work participation requirements to be met through any combination of state-allowable work activities in the first 24 months and federally allowable activities for up to 48 months rather than solely through paid employment, (2) eliminating the retroactive counting of previously exempt and sanctioned months towards the adult recipient's 48-month time limit, and (3) beginning October 2012, implementing a phased in approach to re-engage cases previously exempted under the short-term reforms that otherwise would sunset on June 30, 2012. The revised proposal would provide General Fund savings of $879.9 million in 2012-13.

- *Across-the-Board Reduction in IHSS Hours*—The May Revision reflects a decrease of $99.2 million General Fund in 2012-13 from a 7-percent across-the-board decrease in authorized hours effective August 1, 2012. Similar to the 3.6-percent across-the-board reduction that under current law sunsets on July 1, 2012, recipients may direct the manner in which the reduction of authorized hours is applied to their previously authorized services.

- *Eliminate Domestic and Related Services for Certain IHSS Recipients*—The May Revision reflects savings of $125.3 million General Fund from the proposed elimination of domestic and related services (which include housework, shopping for food, meal preparation and cleanup, laundry, and other shopping and errands) for IHSS beneficiaries residing in a shared living arrangement, since these services can be met in common with other household members.

Other Significant Adjustments:

- *Caseload Projections for Social Services Programs*—A decrease of approximately $65 million General Fund in 2011-12 and $180 million General Fund in 2012-13 as a result of decreased caseload projections in the CalWORKs, Supplemental Security Income/State Supplementary Payment (SSI/SSP), and IHSS programs as compared to the previous budget forecast.

- *Higher IHSS Costs*—An increase of $101.9 million General Fund in 2011-12 and $212.8 million General Fund in 2012-13. The federal government did not approve the IHSS provider tax, which results in a loss of General Fund savings of $57.3 million in 2011-12 and $95.4 million in 2012-13. In addition, actual data demonstrate the savings from making the provision of IHSS services contingent upon a written certification from a licensed health care professional were overstated. This results in a loss of General Fund savings of $44.7 million in 2011-12 and $117.3 million in 2012-13. These costs are in addition to the approximately $166 million in savings that did not materialize. Costs for IHSS are considerably higher than in the 2011 Budget Act.

- *Title IV-E Waiver Carryover*—An increase of $6.6 million General Fund in 2012-13 as a result of carryover funding from previous fiscal years for the Title IV-E Waiver.

Under the terms of the waiver, the participating counties are able to retain unspent funds. These funds must be reappropriated to prevent them from expiring.

- *LEADER Replacement System*—An increase of $36.5 million ($15.3 million General Fund) in 2012-13 to include full-year funding to replace the existing Los Angeles Eligibility, Automated Determination, Evaluation and Reporting system.

Department of Child Support Services

The Department of Child Support Services is designated as the single state agency responsible for administering the statewide child support program.

Proposals to Balance the Budget:

- *Reduce Funding for Local Child Support Agencies*—The May Revision reflects a decrease of $14.7 million ($5 million General Fund) in 2012-13 to reflect reduced funding for Local Child Support Agencies (LCSAs). To assist in achieving this reduction, LCSAs will no longer be required to prepare cases for state hearings and would instead continue their required complaint resolution process and to refer cases to the state for administrative review.

- *Suspend County Share of Collections*—The Governor's Budget proposed to suspend the county share of child support collections in 2012-13. Due to a decreased projection of child support collections, this proposal is now estimated to save $31.9 million General Fund in 2012-13.

- *Reduce California Child Support Automation System Funding*—The May Revision reflects a decrease of $5.5 million General Fund in 2011-12 and $1 million General Fund in 2012-13 associated with the California Child Support Automation System (CCSAS). For 2011-12, the savings will result from an early reversion of remaining CCSAS reappropriation dollars. Beginning in 2012-13, the CCSAS project maintenance and operations budget will be reduced by $2.9 million ($1 million General Fund).

Department of Public Health

The Department of Public Health (DPH) is charged with protecting and promoting the health status of Californians through programs and policies that use population-wide interventions.

Proposals to Balance the Budget:

- *Public Health Laboratory Training Program*—A decrease of $2.2 million in 2012-13 to eliminate the Public Health Laboratory Training Program. This program provides local assistance grants to subsidize training, support, outreach and education, and provides funding for doctoral candidate stipends and post doctoral fellowships for individuals training for public health laboratory directorships. Fifteen individuals currently participate in this program.

- *Increase Client Share of Cost for the AIDS Drug Assistance Program (ADAP)*—The Governor's Budget proposed increasing the client share of cost in the ADAP to the maximum percentages allowable under federal law with a projected savings of $14.5 million General Fund. The May Revision eliminates this share-of-cost requirement for private insurance clients because a cost-sharing obligation will exceed their out-of-pocket costs for private insurance. Additionally, a 90-day delay in implementation is proposed to allow for billing system modifications necessary to implement the proposal. The combination of these changes results in an increase of $3.8 million General Fund. The revised cost sharing proposal achieves General Fund savings of $10.7 million in 2012-13.

Other Significant Adjustments:

- *AIDS Drug Assistance Program*—A net increase of $4.8 million in 2011-12 ($1 million General Fund decrease and $5.8 million other fund increase) and a net increase of $30.1 million in 2012-13 ($4.1 million General Fund decrease and $34.2 million other fund increase). Major program changes include a delay in program clients enrolling in county Low Income Health Programs, increased federal funds through the Ryan White Part B grant, a decrease in Safety Net Care Pool funds, and an increase in the projected drug rebate collection rate.

- *Women, Infants and Children (WIC) Program*—An increase of $26 million WIC Manufacturer Rebate Fund in 2012-13, and a corresponding decrease in federal authority. The increase in rebate funds is the result of a new contract award for infant formula rebates effective August 1, 2012. Federal law requires the use of WIC manufacturer rebate revenues prior to using federal WIC food funds. Therefore, it is necessary for the DPH to increase its rebate authority to maintain compliance with federal requirements.

- *California Reducing Disparities Project*—An increase of $15 million Mental Health Services Fund in 2012-13, with the intent of providing a total of $60 million toward the project. This funding continues statewide efforts to improve access to mental health services and quality of care, and increase positive outcomes for underserved communities.

Department of Developmental Services

The Department of Developmental Services (DDS) serves approximately 250,000 individuals with developmental disabilities in the community and 1,760 individuals in state-operated facilities. The May Revision includes $4.7 billion ($2.7 billion General Fund) for support of the department and community services. Services are provided through the developmental centers and one community facility and the regional center system.

Proposal to Balance the Budget:

- *Developmental Services Systemwide Reductions*—The General Fund decrease of $100 million proposed at Governor's Budget will be achieved by reducing expenditures and increasing the receipt of federal funds. This savings proposal was annualized to $200 million in 2012-13. Of this total, $120.2 million is related to new policy proposals. Savings will be achieved by increasing eligibility for federal funding, increasing insurance billing for certain autism-related services, redesigning options for consumers who have been hard to serve in the community, and a 1.25-percent payment reduction.

Other Significant Adjustment:

- *Proposition 10 Funding*—This proposal reflects $40 million to be provided by the First 5 California Children and Families Commission for programs serving children ages birth through five. This funding will support the DDS Early Start Program, decreasing General Fund costs by $40 million.

Department of State Hospitals

The former Department of Mental Health is transferring community mental health programs to other departments, and is being restructured to focus on administering the California state hospital system, the Forensic Conditional Release Program, the Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed and voluntary patients. The May Revision includes $1.4 billion ($1.3 billion

General Fund) in 2012-13 for support of the Department. The patient population is projected to reach a total of 6,439 in 2012-13.

Significant Adjustment:

- *2011-12 Operating Shortfall*—The Governor's Budget originally identified a current year shortfall of approximately $180 million General Fund, due to various unfunded activities within the state hospital system. Through a series of cost-savings proposals, including a staffing ratio adjustment, the use of generic drugs and personal service contract rate revisions, and minor program restructuring, the shortfall at Governor's Budget was reduced to $63 million General Fund. The May Revision includes an additional reduction of $21 million General Fund, bringing the estimated shortfall to $41.7 million General Fund. The reduction results from a decrease in the estimated population census.

Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation (CDCR) incarcerates the most serious and violent felons, supervises them when they are released on parole, and provides rehabilitation programs to help them reintegrate into the community.

The May Revision includes total funding of $9 billion ($8.8 billion General Fund and $201.6 million other funds) for the CDCR in 2012-13.

State Prisons

In April 2012, the Administration released a comprehensive plan to save billions of dollars, end federal court oversight and improve the prison system. This plan builds upon the changes brought by public safety realignment and provides a clear path for the Department to save $1 billion in 2012-13, growing to $1.5 billion in 2015-16, and satisfy court orders related to reducing overcrowding and providing a constitutionally required level of health care. The primary components of the plan include the following:

- *Updating Inmate Classification Score System*—As a result of research produced by a panel of correctional experts and input from seasoned professionals, the CDCR is modifying its inmate classification score system. The modified system will enable the Department to safely shift approximately 17,000 inmates to less costly housing where they can benefit from access to rehabilitative programs.

- *Returning Out-of-State Inmates to California*—Currently, California is paying to incarcerate approximately 10,000 inmates in private, out-of-state prisons. The plan enables the CDCR to return these inmates as the in-state prison population continues to drop, classification changes are made, and additional housing units are added at existing prisons. Returning these inmates to California will stop the flow of taxpayer dollars to other states and is expected to save the state $318 million annually upon full implementation.

- *Restructuring Rehabilitation Programs*—The plan will help lower the long-term prison population and save the state money by efficiently providing targeted rehabilitation programs. The plan allows at least 70 percent of the Department's target population to participate in academic and rehabilitation programs consistent with their needs. Programming yards will also be established to encourage positive behavior. The CDCR will also establish reentry hubs with concentrated programming resources at existing prisons to better prepare inmates as they near release. Within their first year of release, approximately 70 percent of parolees who need substance-abuse treatment, employment services, or education will have access to these programs.

- *Standardizing Staffing Levels*—The plan establishes new, efficient, and uniform staffing standards for each prison. Correctional experts reviewed the custody and non-custody positions in each prison with the objective of achieving savings by reducing staff to the minimum amount necessary to operate safely, while also facilitating appropriate out of cell time and access to programming and health care.

- *Reducing the Budget for Adult Parole Operations*—As a result of public safety realignment, the active adult parolee population is projected to decline to approximately 30,000 offenders by 2015-16. The plan includes a complete restructuring of the Division of Adult Parole Operations budget to ensure that it downsizes at a rate commensurate with the decline in population.

- *Eliminating Unnecessary Lease Revenue Bond Authority*—The plan includes trailer bill language to extinguish approximately $4.1 billion of previously authorized AB 900 lease revenue bond authority. Eliminating this bond authority and no longer needing to build new stand-alone prisons will avoid $2.2 billion annually in new operating costs and facility debt service costs.

- *Closing and Replacing Facilities*—The plan closes the California Rehabilitation Center (CRC), repurposes the DeWitt Nelson Youth Correctional Facility as an annex to the California Health Care Facility, reactivates the Folsom Transitional Treatment Facility for female offenders, and replaces capacity lost by the closure of CRC with up to three efficient and flexible dorm facilities at existing prisons. The plan also includes the renovation of medical care facilities at existing institutions.

- *Returning Control of Health Care to the State*—In recent years, numerous measures have been implemented that significantly improved the quality of the Department's health care system. The Inspector General regularly reviews and scores the Department's medical care system, and these scores have been steadily rising. The plan provides for increased health care capacity through the activation of the California Health Care Facility in Stockton, and its annex the DeWitt Nelson Youth Correctional Facility. These projects will create a unified health care complex allowing both facilities to efficiently transition inmate-patients between the two, while avoiding transportation and security costs as well as the need for expensive services in community hospitals and clinics. In addition, existing mental health office and treatment space and dental projects will continue. All of these projects, along with new plans to increase medical clinical capacity at existing prisons, will satisfy court imposed requirements.

- *Satisfying the Supreme Court's Order to Reduce Prison Crowding*—As outlined in the Department's plan, the newly released spring population projections suggest that the Department may fall a few percentage points short of meeting the final court-ordered crowding-reduction benchmark even with realignment. In June 2013, the Department's prison population is projected to be at 141 percent of design capacity rather than the 137.5-percent goal identified by the Supreme Court. The additional measures proposed in the Department's plan will allow the state to seek and obtain from the court a modification to raise the final benchmark to 145 percent of design capacity.

- *Increasing Fiscal Oversight and Accountability*—The plan includes trailer bill language that requires the Department of Finance's Office of State Audits and Evaluations to monitor CDCR's implementation of this plan and provide annual reports to the Governor and the Legislature through 2015-16.

Other Significant Adjustments:

- *Ending the Receivership*—In 2006, the federal courts in the *Plata v. Brown* case appointed a Receiver with full authority over prison medical care. The Receiver was empowered to spend whatever he deemed necessary to bring California prison medical care up to a Constitutional level. In May of 2012, the state filed a report to terminate the Receivership. Ending the Receivership will return oversight and accountability of medical care to the state.

- *Funding for the Inmate Medical Services Program*—The May Revision includes an increase of $295.4 million General Fund in 2011-12 and $128.4 million General Fund in 2012-13 to fund court-required inmate medical costs. These augmentations align the medical care budget with the Receiver's projected expenditures and include resources to operate the California Health Care Facility opening in the summer of 2013.

Division of Juvenile Justice

Proposals to Balance the Budget:

- *Division of Juvenile Justice (DJJ)*—The May Revision retains DJJ for the housing and treatment of the most serious and violent juvenile offenders. It proposes efficiencies and other policy changes to reduce the state's costs of housing and supervising wards under the jurisdiction of DJJ. Net savings to the state of $24.8 million General Fund in 2012-13 is comprised of the following components:
  - Reduce administrative staff within headquarters and DJJ facilities. The *Farrell* court requires specific staffing levels within DJJ. The May Revision does not impact any positions tied to the *Farrell* lawsuit. However, the CDCR plans to continue working with the *Farrell* court to achieve further staffing reductions to help decrease the high cost of housing offenders in DJJ.
  - End juvenile parole on January 1, 2013 instead of July 1, 2014.
  - Reduce DJJ's age of jurisdiction from 25 to 23.
  - Implement a new fee structure to charge counties $24,000 per year for each offender committed by a juvenile court to the DJJ.

Other Significant Adjustment:

- *Juvenile Population Adjustment*—A decrease of $3.4 million ($2.2 million General Fund, $1.1 million Proposition 98 General Fund, $95,000 other funds) in 2011-12, and a decrease of $9.1 million ($7.2 million General Fund, $1.6 million Proposition 98 General Fund, $229,000 other funds) in 2012-13 to reflect revised population projections. Adjusted for recent juvenile population trends, the May Revision reflects an estimated average daily population of 992 wards in 2012-13, which is 156 less than projected in the Governor's Budget.

Board of State and Community Corrections

Legislation associated with the 2011 Budget Act abolished the Corrections Standards Authority and established the Board of State and Community Corrections as an independent entity, effective July 1, 2012. The Board will assume the previous functions of the Authority as well as other public safety programs previously administered by the California Emergency Management Agency.

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 May Revision includes total funding of $119.9 million ($27.7 million General Fund and $92.2 million other funds) for the state operations and local assistance programs included under this Board.

Other Significant Adjustments:

- *Grants for City Police Departments*—Current economic conditions have resulted in budget reductions for city police departments. To help mitigate these reductions, the May Revision includes $20 million General Fund to create a new grant program for city police departments.
- *Local Jail Construction Financing Program*—Trailer bill language is proposed to provide $500 million of additional lease revenue bond financing authority for the acquisition, design, and construction of local facilities to help counties manage their offender population. This authority would be in addition to the $1.2 billion lease revenue bond financing authority authorized in AB 900 for two phases of the Local Jail Construction Financing Program.

Public Safety Realignment

The 2011 Budget included a major realignment of public safety programs from the state to local governments. It moves program and fiscal responsibility to the level of government that can best provide the service, eliminating duplication of effort, and increasing flexibility. The implementation of the Community Corrections Grant Program authorized by Chapter 15, Statutes of 2011 (AB 109) will end the costly revolving door of lower-level offenders and parole violators through the state's prisons.

With resources and program responsibility at the local level, each county Board of Supervisors can integrate programs to best meet the needs of its citizens and achieve better outcomes.

Funding Structure for 2011 Realignment

The 2011 Realignment is funded through two sources—a state special fund sales tax of 1.0625 percent and a dedicated portion of Vehicle License Fees (VLF). Although the revenue stream for 2011 Realignment is ongoing, the initial program allocations were for the 2011-12 fiscal year only.

In the May Revision, the Administration is proposing trailer bill language to create a permanent funding structure for 2011 Realignment. The funding structure is designed to provide local entities with a known, reliable, and stable funding source for these programs. Within each Subaccount, counties will have the flexibility to meet their highest priorities, and will be able to use their funds to draw down the maximum amount of federal funding for these programs. In those programs in which there are federal requirements, such as eligibility and statewideness, counties will be responsible for meeting those requirements. The state is committed to assisting counties as appropriate if they need federal state plan amendments, waivers, or other flexibilities.

Figure REA-01 identifies the programs and funding for 2011 Realignment, displaying the program allocation structure in place for the 2011-12 fiscal year. The May Revision estimates the sales tax to be $5.2 billion and the VLF to be $439.4 million in 2011-12, and the sales tax and VLF values are projected to increase to $5.4 billion and $455.1 million, respectively, in 2012-13. Compared to the program allocation and funding chart included in the Governor's Budget Summary, the 2011-12 funding level for several programs has increased.

Figure REA-01

2011 Realignment Funding

(Dollars in Millions)

Program	2011-12	2012-13	2013-14	2014-15
Court Security	$496.4	$496.4	$496.4	$496.4
Public Safety Programs	489.9	489.9	489.9	489.9
Local Jurisdiction for Lower-level Offenders and Parole Violators				
Local Costs	239.9	581.1	759.0	762.2
Reimbursement of State Costs	989.9	-	-	-
Realign Adult Parole				
Local Costs	127.1	276.4	257.0	187.7
Reimbursement of State Costs	262.6	-	-	-
Mental Health Services				
EPSDT	-	584.2	584.2	584.2
Mental Health Managed Care	-	196.7	196.7	196.7
Existing Community Mental Health Programs	1,083.6	1,120.6	1,120.6	1,120.6
Substance Abuse Treatment	183.6	183.6	183.6	183.6
Foster Care and Child Welfare Services	1,567.2	1,585.4	1,605.8	1,621.1
Adult Protective Services	55.0	55.0	55.0	55.0
Existing Juvenile Justice Realignment	97.1	98.8	98.8	98.8
Program Cost Growth	-	221.7	456.6	1,014.7
Total	**$5,592.3**	**$5,889.8**	**$6,303.6**	**$6,810.9**
1.0625% Sales Tax	5,152.9	5,434.7	5,840.3	6,339.8
Motor Vehicle License Fee Transfer	439.4	455.1	463.3	471.1
Total Revenues	**$5,592.3**	**$5,889.8**	**$6,303.6**	**$6,810.9**

Changes to Allocation Levels since the Governor's Budget

The base for each of the programs included in 2011 Realignment will ultimately become a "rolling base," meaning the previous year's allocation level plus growth will equal the new base for the following year. However, the year in which the base is defined varies by program. The base for the following programs is established in 2011-12, and the allocation level for each has changed since the Governor's Budget.

- The allocation for Substance Abuse Treatment programs has increased by $3.9 million, from $179.7 million to $183.6 million. These funds will be included in the Behavioral Health Subaccount beginning in 2012-13.
- The allocation for Foster Care, Child Welfare Services, and Adult Protective Services has increased by $5.5 million, from $1,616.7 million to $1,622.2 million. These funds will be included in the Protective Services Subaccount beginning in 2012-13.

The 2011-12 funding level for each of the above programs was aligned with the estimated cost of these programs as of the 2011 Budget Act, which is higher than the estimated cost of these programs as of the 2012-13 May Revision, based on the latest caseload and cost-per-case data. Although the allocation levels above are higher than current estimates, this better positions the counties to adapt to future caseload changes, particularly in the programs that are federal entitlements.

Although the 2011-12 funding level establishes the base for many of the Health and Human Services programs, the base for Mental Health Services and Foster Care/Child Welfare Services is established differently. Changes in the allocation levels for these programs are as follows:

- The 2011-12 allocation for Existing Community Mental Health Programs is $1,083.6 million, which represents the amount that will be allocated to the Mental Health Account pursuant to the formula in statute for 2011-12. This amount is greater than the $1,068.8 million that is now estimated to have been available for Mental Health in 2011-12 under 1991-92 Realignment.
- The 2012-13 allocation for Existing Community Mental Health Programs is $1,120.6 million, which represents the amount that is estimated to otherwise have been available for Mental Health in 2012-13 under 1991-92 Realignment. Although this is less than the $1,164.4 million reflected in the Governor's Budget, Mental Health programs have a dedicated growth account in the new ongoing

funding structure. These programs also will continue to receive any Mental Health growth resulting from 1991-92 Realignment.

- The allocation for the Early and Periodic Screening, Diagnosis, and Treatment program and the Mental Health Managed Care program has increased by $48.1 million, from $732.8 million to $780.9 million. The 2012-13 funding level for these programs establishes the base. These funds will be included in the Behavioral Health Subaccount beginning in 2012-13.
- The allocation for Foster Care and Child Welfare Services for 2012-13, 2013-14, and 2014-15 reflects the costs for counties to expand foster care benefit eligibility up to age 21 as authorized by Chapter 559, Statutes of 2010 (AB 12) for a cumulative increase of $53.9 million. These funds will be included in the Protective Services Subaccount and will be phased in over a three-year period beginning in 2012-13.

Judiciary

The May Revision includes total funding of $3.6 billion ($730 million General Fund) for the Judiciary.

The Judicial Branch consists of the Supreme Court, courts of appeal, trial courts, and the Judicial Council. The trial courts are funded with a combination of funding from the General Fund, county maintenance-of-effort requirements, fines, fees, and other charges. The state-level judiciary receives most of its funding from the General Fund.

During the mid-1990's there were significant reforms in the Judicial Branch—court unification and the state assumption of funding responsibility for trial courts. Prior to state funding, many small courts were in financial crisis and needed emergency state funding to keep their doors open. One of the goals of state funding was to promote equal access to justice so that a citizen's access to court services was not dependent on the financial health of an individual county. Trial courts have benefitted financially, as the state has been able to stabilize and increase funding.

Fifteen years after the implementation of the Trial Court Funding Act, a comprehensive evaluation of the state's progress in achieving the goals outlined in the reform legislation, including the ability of trial courts to provide equal access to justice, is appropriate. The Administration proposes to establish a working group to conduct the evaluation. The working group will conduct a statewide analysis of workload metrics, staffing standards, and other relevant data necessary to support a more uniform and efficient administrative system for the judiciary.

Since 2007-08, state General Fund support for the Judicial Branch has been reduced by $653 million ongoing. However, the Administration, the Legislature and the Judicial Council have mitigated these reductions through a mix of permanent and one-time offsets, including transfers from special funds, fee increases, and use of trial court reserves. Overall expenditures for the trial courts have remained relatively flat as illustrated in Figure JUD-01. Beginning in 2013-14, because of reliance on one-time reductions and the loss of reserves and fund balances, trial courts will need to achieve reductions through operational changes and efficiencies.

Figure JUD-01

Judicial Branch Expenditures, State Funds
2007-08 Through 2012-13
(Dollars in Thousands)

Judicial Branch Expenditures by Program	2007-08	2008-09	2009-10	2010-11	2011-12 Estimated	2012-13 Projected [2]	2007-08 vs. 2012-13
Supreme Court	$44,397	$44,808	$43,933	$43,953	$43,406	$42,882	-3.5%
Courts of Appeal	200,706	212,779	203,167	206,760	200,084	198,348	-1.2%
Judicial Council	130,396	134,378	136,697	137,456	126,372	124,962	-4.3%
Habeas Corpus Resource Center	12,553	13,857	13,659	13,570	13,629	13,409	6.4%
Facility Program Adjusted [1]	22,634	25,891	21,947	25,518	35,896	37,465	39.6%
Trial Courts Adjusted	3,316,204	3,321,013	3,362,324	3,559,532	3,552,011	3,367,302	1.5%
Total	**$3,726,890**	**$3,752,726**	**$3,781,727**	**$3,986,789**	**$3,971,398**	**$3,784,368**	**1.5%**

Adjustments to Trial Courts Governor's Budget Totals	$3,288,873	$3,237,891	$3,060,624	$3,218,101	$2,666,980	$1,959,385
Trial Court facility expenses	*$27,331*	*$83,122*	*$150,000*	*$175,431*	*$172,631*	*$195,517*
Use of local trial court reserves	*0*	*0*	*0*	*0*	*0*	*402,000*
Transfers from various special funds	*0*	*0*	*151,700*	*166,000*	*216,000*	*314,000*
Redirections of trial court expenditures:	*0*	*0*	*(5,000)*	*0*	*(86,400)*	*(126,000)*
Sub-total, Trial Courts	**$3,316,204**	**$3,321,013**	**$3,362,324**	**$3,559,532**	**$3,055,611**	**$2,870,902**
Trial Court Security [3]	*(444,901)*	*(475,332)*	*(471,310)*	*(480,999)*	*496,400*	*496,400*
Adjusted Total, Trial Courts	**$3,316,204**	**$3,321,013**	**$3,362,324**	**$3,559,532**	**$3,552,011**	**$3,367,302**

[1] The Facility Program budget has been adjusted to remove all expenditures for trial court operations.
[2] The $350 million unallocated reduction included in the 2011 Budget Act is scheduled to each program consistent with the 2011-12 allocation.
[3] For comparison purposes, 2011-12 and 2012-13 include $496.4 million in court security costs that were historically included in trial court expenditures. Security costs for 2007-08 through 2010-11 are shown for display purposes, but are included in the trial court's budget.

While the state has made difficult cuts and reduced its services, trial courts have largely been held harmless from budget reductions. The state's current fiscal situation requires further reductions. Therefore, the May Revision proposes $544 million in General Fund reductions in 2012-13. Of this amount, $419 million is one-time and $125 million is ongoing. In 2012-13, $540 million affects the trial courts, but is fully offset by the use of trial court reserves and delays in court construction. The remaining $4 million will be achieved by permanent changes in retirement contributions for the AOC, including staff within the Supreme Court, Courts of Appeal and the Habeas Corpus Resource Center. Additional permanent reductions include $50 million in court construction project savings that will be redirected to support trial court operations.

Proposals to Balance the Budget:

- *Restructure Trial Court Funding*—Decrease of $300 million General Fund on a one-time basis and offset each trial court's allocation by their available reserve. A statewide reserve equal to 3 percent of the statewide allocation to trial courts will be held at the state level. The Judicial Council will be authorized to allocate funds from the statewide reserve to individual courts as necessary to address emergencies and unavoidable budget shortfalls.

  By the end of 2010-11, the trial courts had accumulated approximately $562 million in reserves, a five-percent increase since 2008-09. Reserves vary among the individual trial courts. These reserves will make it possible for the state to achieve substantial savings while maintaining trial court operations.

- *Delay Court Construction*—Decrease $240 million General Fund on a one-time basis by redirecting an equal amount from court construction funds to support trial court operations. This pause in construction will delay design activities for up to 38 court projects. It will coincide with a full review of the court construction program and court construction standards. Up to six projects that are near design completion are proposed to proceed to construction in 2012-13 once the Judicial Council is able to verify the cost and scope of these six projects. These projects will be funded with lease revenue bonds. Ongoing, $50 million will be redirected from court construction funds to support trial court operations.

- *Increase Retirement Contributions for State Court Employees*—An ongoing reduction of $4 million General Fund by increasing the retirement contribution for state court employees from five percent to eight percent, consistent with other state employees. The May Revision also assumes that the practice of paying the employee retirement contribution will be discontinued.

Natural Resources

As currently structured, the Natural Resources Agency consists of 27 departments, boards, commissions, and conservancies responsible for administering programs to conserve, protect, restore, and enhance the natural, historical, and cultural resources of California.

The May Revision includes total funding of $8.5 billion ($1.9 billion General Fund and $6.6 billion other funds) for all programs included in the Agency.

Timber Harvest Plan Reform

The Governor's Budget outlined the Administration's commitment to improving the health of California forests, continuing California's commitment to the environment, supporting the state's climate and energy goals, and meeting with stakeholders to receive input in developing a proposal to improve the Timber Harvest Plan process. The May Revision proposes a reform package that includes the following elements:

- Administrative Improvements—These changes will improve state department coordination of the current regulatory process with a goal to shorten and streamline permit processing times for Timber Harvest Plans utilizing existing resources:
    - Redding Pilot Project—Development and implementation of a year-long pilot project to test procedures to improve the efficiency of a multi-agency Timber Harvest Plan review team.

  - Timber Harvest Plan Documentation Review—A review of the current content and organization of the Timber Harvest Plan application document to improve ease of preparation, continuity of plan content, and reduction of applicant errors. The review will also explore the ability to use out e-forms.

- Lumber Assessment—The new assessment will be applied to retail sales of certain wood products sold in California and will be collected by the Board of Equalization. The assessment will be used to support the regulatory activities of the Departments of Forestry and Fire Protection, Fish and Game, Conservation, and State Water Resources Control Board related to Timber Harvest Plan review. The assessment will provide a long-term funding stream to fund the regulatory agencies, provide opportunities for future restoration of California forests, and increase timber production.

- Extension of Current Timber Harvest Plans—Timber Harvest Plans are currently effective for three years with two one-year extensions. The proposal will extend that timeframe to five years with one two-year extension and would affect plans approved in 2012. This timeframe will optimize the length and scope of standard timber harvest plans while retaining appropriate protective measures for fish and wildlife.

- Limit Damages from Wildfire Liability—California law allows recovery of up to double damages for damages related to wildfires. This leads to claims far exceeding restoration costs. The proposal would limit the scope of damages for fire cases and prohibit excessive damages.

Energy Resources Conservation and Development Commission

The Energy Resources Conservation and Development Commission (Energy Commission) is responsible for ensuring a reliable supply of energy to meet state needs while protecting public health, safety, and the environment.

Other Significant Adjustment:

- *Electricity Program Investment Charge Program*—The May Revision includes an increase of $2.1 million (other funds) in 2012-13 for the Energy Commission to begin the administration and development of the Electricity Program Investment Charge program that was adopted by the Public Utilities Commission. The Electricity

Program Investment Charge is intended to support cost-effective energy efficiency and conservation activities, renewable energy resources, and public interest research and development. The Energy Commission has been designated as the administrator of the Electricity Program Investment Charge program and will utilize the requested resources to develop a triennial investment plan to be submitted to the Public Utilities Commission.

Department of Resources Recycling and Recovery

The Department of Resources Recycling and Recovery (CalRecycle) protects public health, safety, and the environment by regulating solid waste facilities and promoting recycling.

Other Significant Adjustment:

- *Beverage Container Recycling Fund Redemption Payments*—The May Revision proposes to require beverage container distributors to submit beverage container redemption payments to CalRecycle by the last day of the first month following sale, rather than the last day of the second or third month following sale. CalRecycle makes payments from the Beverage Container Recycling Fund to container recyclers and processors within 20 days, but under current law distributor payments to the Fund have to be made within 60 to 90 days. This proposal will better align the state's cashflows with container recyclers and processors.

Department of Water Resources

The Department of Water Resources protects, conserves, and manages California's water. The Department evaluates existing water resources, forecasts water needs, and explores potential solutions to meet growing needs. The Department also works to prevent and minimize flood damage, ensure the safety of dams, and educate the public about the importance of water and its efficient use.

Other Significant Adjustment:

- *Davis-Dolwig Resolution*—The May Revision proposes a $10 million continuous appropriation from the Harbors and Watercraft Revolving Fund to fund the state's obligations under the Davis-Dolwig Act. The Davis-Dolwig Act, passed by the voters in 1961, describes how recreation, fish, and wildlife enhancements are achieved and funded in association with the California State Water Project. The Harbors and Watercraft Revolving Fund is an appropriate funding source because a significant percentage of boating facilities in the state are at State Water Project facilities and Davis-Dolwig costs are primarily attributed to boating. This proposal will resolve a long-standing problem and will provide a reliable source of funding for the Department and state water contractors as they continue to manage and improve the state's water delivery system.

Business, Transportation, and Housing

The programs within the Business, Transportation, and Housing Agency promote the state's business and economic climate, transportation infrastructure, and affordable housing. The Agency also includes public safety programs, including the Department of Motor Vehicles, the California Highway Patrol, and the Department of Alcoholic Beverage Control. Funding for all programs exceeds $19.7 billion, which is derived largely from special fund revenues, federal funds, and bond proceeds.

Department of Transportation

The Department of Transportation (Caltrans) has almost 20,000 employees and a budget of $13.2 billion. Caltrans designs and oversees the construction of state highways, operates and maintains the highway system, funds three intercity passenger rail routes, and oversees funding for local mass transit projects. Approximately 50,000 road and highway lane miles and 12,910 state bridges are maintained, and 812 public-use and special-use airports and heliports are inspected. The largest sources of funding for transportation projects are excise taxes paid on fuel consumption, federal funds also derived from fuel taxes, and weight fees on trucks. Bond funds currently provide approximately 30 percent of the total funding available.

Proposal to Balance the Budget:

- *Special Fund Transfers to the General Fund*—A transfer of $184 million in 2011-12 and $128.2 million annually starting in 2012-13 from several special funds to the

General Fund. The fuel tax swap enacted in the 2010 Budget Act eliminated the state sales tax on gasoline and increased the gasoline excise tax by a like amount. A portion of the new excise tax revenue on gasoline is attributable to fuel purchased for off-highway vehicles. Unlike the other transportation funds, these revenues are not restricted by the state Constitution. The structural components of the fuel tax swap will continue, including funding related to the backfill of Proposition 42 sales tax dollars. Specifically, the May Revision includes $708.5 million for local roads and $901.7 million for Caltrans highway projects associated with former Proposition 42 funding. Revenues for off-highway programs funded from the base 18-cent excise tax will not be affected by this proposal.

Other Significant Adjustments:

- *Implementation of the Northern California Unified Rail Service*—An increase of $705,000 Public Transportation Account and seven positions in 2012-13 to enable Caltrans to work with the High-Speed Rail Authority and other local and regional rail operators to improve service on Northern California intercity rail lines, consistent with the blended system presented in the High-Speed Rail Authority's revised 2012 Business Plan. Upon completion of the first construction segment of the Initial Operating Section, the upgraded infrastructure will enable trains to operate at speeds of up to 125 miles per hour between Bakersfield and the Bay Area and Sacramento, compared to the existing maximum speed of 79 miles per hour. These positions will start the early planning work necessary to begin operation upon completion of the first construction segment in 2018.
- *Capital Outlay Support (COS)*—A reduction of $14.5 million (other funds) and 330 state positions in 2012-13 for engineering, design, and construction oversight activities in Caltrans' COS Program. While Proposition 1B work continues, overall Caltrans' COS workload is anticipated to decrease significantly as a result of the expiration of federal American Recovery and Reinvestment Act funds. This proposed level of staffing will establish an 89/11 percent split of state staff to architectural and engineering consultant contracts consistent with the State Auditor's recommendation that Caltrans utilize flexible staff resources to ramp down state staff based on future workload needs, which are expected to decrease as Proposition 1B projects approach completion. This proposal will represent the lowest number of positions in the COS Program since 1997-98.

Department of Motor Vehicles

The Department of Motor Vehicles has a budget of approximately $963.6 million and more than 8,221 positions to license California drivers, register vehicles, and provide identification cards.

Proposal to Balance the Budget:

- *Special Fund Loan to the General Fund*—A loan of $300 million in 2012-13 from the fund balance in the Motor Vehicle Account (MVA). The MVA collects revenues from vehicle registrations and for the issuance of drivers' licenses and identification cards. Due to savings from the workforce cap, other operational efficiencies, and the completion of several projects, the MVA will accumulate a larger fund balance than is needed for budget year operations. The May Revision proposes to withdraw the $5 fee reduction proposed in the Governor's Budget, and to instead loan these resources to the General Fund. The MVA will still retain a prudent fund balance after the $300 million loan. The loan will be repaid by June 30, 2016.

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State Government

Over the last year and a half, significant operational changes have downsized state government and achieved efficiencies. The Governor's Budget built on these changes by proposing a comprehensive package of additional efficiencies, including streamlining the state's organizational structure, eliminating unnecessary boards and commissions, and improving budget accountability and transparency. The May Revision furthers these efforts as described below. The May Revision also includes reductions in external contracts, the use of retired annuitants, and employee compensation.

Improving State Government

- *Governor's Reorganization Plan*—On May 3, 2012, the Governor submitted to the Legislature an expansive plan to streamline the state's organizational structure and make it more cohesive, accessible, and efficient. The plan cuts the number of state agencies from 12 to 10 and consolidates and aligns related programs and departments. In April, the plan was sent to the Little Hoover Commission to review as part of the statutory reorganization process. The Commission is expected to submit its findings and recommendations to the Legislature on or about May 22, 2012. Upon implementation, the Governor's plan will improve the management and coordination of government activities, which will facilitate further efficiencies and reduce costs.

- *Elimination of Boards and Commissions*—The May Revision proposes to eliminate 22 boards, commissions, and advisory groups that have been identified as outdated, defunct, or duplicative. These, along with those eliminated in the 2011 Budget Act and proposed for elimination in the Governor's Budget, will bring the total elimination of state entities and programs to more than 80 since 2010-11.

- *Improve the Budget Process through Zero-Basing and Other Tools*—Executive Order B-13-11 directed the Department of Finance to develop budget methods that require more information about program performance in the annual budget process. Working with the Department of Finance and the Legislature, the departments of Transportation, Human Resources, Consumer Affairs, and Public Health will incorporate an outcome-based approach into their traditional budget process. The Administration has already conducted a zero-based review of several departments and programs, and will undertake more reviews in the coming year.
- *Eliminate Unnecessary Reports*—Departments and agencies spend significant effort tracking, preparing, and submitting reports to the Legislature about state programs and activities that may no longer be of value. All departments conducted an extensive review of reporting requirements and identified 700 legislative reports that are unnecessary, or already met reporting requirements, that should be eliminated.

State Workforce

- *Reduce Reliance on External Contracts*—To achieve savings, the Administration will reduce its use of external state contracts. Specifically, it will decrease vendor support for information technology oversight by developing professional expertise in the state workforce. In addition, the Department of General Services, in consultation with departments, will evaluate all personal services contracts, including janitorial and security services, and transition that work to state employees where appropriate.
- *Eliminate Non Essential Hiring of Retired Annuitants*—The Administration will direct all departments to review their use of Retired Annuitants and other temporary employees. Only those that have been deemed critical to the department's core mission will be retained.
- *Permanently Reduce the State Workforce*—More than 15,000 positions were eliminated in 2011-12 through budget reductions. A department-by-department review of historic vacancies identified an additional 11,000 positions that will be permanently eliminated in the May Revision. This adjustment will accurately reflect department staffing levels. Including all reductions proposed in the 2012-13

Budget, the Brown Administration will have achieved a total reduction of more than 30,000 positions.

- *Employee Compensation*—The May Revision proposes savings of $839.1 million ($401.7 million General Fund) in employee compensation, equivalent to a 5 percent reduction in pay. In the coming weeks, the Administration will work with labor organizations to achieve these savings. It is the Administration's intention to avoid a furlough program and to mitigate layoffs. To this end, the Administration will pursue the implementation of a four-day, 38-hour workweek for the majority of state employees to achieve the necessary savings. The four-day workweek with longer work hours will allow state government to continue to serve the public by providing access to services outside of traditional work hours. This schedule will also reduce energy usage in state-owned and leased buildings. The Administration will pursue commensurate reductions in work hours and pay for employees of entities that operate 24 hours a day, 7 days a week when implementation of the four-day workweek is not feasible. In addition, the Administration will continue to pursue changes to health coverage for employees and retirees to reduce costs for both employees and the state. Absent changes, health care costs are expected to increase by 10 percent in the coming year.

Reductions in Special Fund Programs

The May Revision proposes the following reductions to departments funded by special funds:

- *Department of General Services*—A decrease of $108.4 million special funds and 45.5 positions to reflect savings in the following areas:
  - $75 million reduced expenditure authority for the Natural Gas Program.
  - A decrease of $15.4 million for the Office of State Publishing by increasing use of automation and technology, restructuring procurement processes, and consolidating space needs.
  - A decrease of $6.7 million for the Real Estate Services Division programs by streamlining submittal processes, renegotiating leases, and reducing travel.
  - A decrease of $6.3 million for the Building Regulation Services by increasing the use of technology and eliminating duplicative meetings.

  - A decrease of $5 million for administration and statewide support by centralizing purchasing, consolidating shared services with other divisions, reducing office equipment costs, and reducing travel costs.

- *California Technology Agency Rate Reductions*—A decrease in rates for data center services of $13 million ($1.9 million General Fund) in 2012-13, based on reduced costs in the mainframe and mid-range service areas. In 2011-12, data center rates were reduced by $21.4 million ($3.1 million General Fund) on a one-time basis, due primarily to a temporary spike in mainframe utilization and other limited-term savings.

- *Toxic Substances Control Account Reductions*—A decrease of $9.1 million other funds and 24 positions in 2012-13 and $12.6 million other funds and 59.8 positions ongoing to align expenditure authority with projected revenues. The Department of Toxics Substances Control is also shifting $6.2 million and 52.3 positions to federal funds, reimbursements, and other state funds. These actions will bring the account into structural balance while redirecting resources to implement high-priority activities under the Safer Consumer Products Program.

Reducing State Real Estate Costs

The state continues to implement efforts to improve the state's management of assets. Since last year's May Revision, the Department of General Services (DGS) continues to make progress in this area and has identified further opportunities to better manage the state's real estate holdings. To emphasize the Administration's commitment in this area, the Governor issued Executive Order B-17-12 directing DGS to take additional measures to reduce real estate leasing costs, review office consolidation opportunities, reduce the amount of square footage leased by state agencies, and examine opportunities to eliminate or reduce warehouse space. The Administration will be pursuing the sale of up to seven Capital Area Development Area properties.

Various Departments and Issues

This section provides budget information for various departments, statewide expenditures, and regarding local governernments.

Redevelopment Agencies

Chapter 5, Statutes of 2011 (ABx1 26), eliminated redevelopment agencies (RDAs) and designated local organized successor agencies tasked with retiring the former RDAs' outstanding debts and other legal obligations.

The California Redevelopment Association and other entities challenged ABx1 26 before the California Supreme Court in the case *California Redevelopment Association et al. v. Matosantos et al*. In a ruling released on December 29, 2011, the Court upheld ABx1 26. In accordance with the Court's order, RDAs were dissolved on February 1, 2012. Revenues that would have been directed to the former RDAs are now provided to the successor agencies to pay the debts of the former RDAs, and to make the "pass-through" payments to which affected taxing entities were entitled before the RDAs were dissolved. The revenues remaining after debt service and pass-through payments are distributed as property taxes to cities, counties, school and community college districts, and special districts under existing law.

Elimination of RDAs will provide additional property tax funding for education, yielding a General Fund savings by reducing the state's funding obligation under Proposition 98. The May Revision reflects an estimate that approximately $818 million in additional property tax revenue will be received by K-14 schools in 2011-12 as a result of ABx1 26, which is down from the $1.05 billion that was estimated in the Governor's Budget. The May Revision estimates $991 million in additional property tax revenue will be received by K-14 schools in 2012-13, which is down from the $1.08 billion estimated in the Governor's Budget. The revised estimates are based on a sample of payments reviewed by the Department of Finance and updated property tax information.

Beginning in 2012-13, the May Revision proposes that K-14 schools be allowed to retain 1 percent of the property tax annually received pursuant to ABx1 26 above the Proposition 98 guarantee. This equates to approximately $10 million in 2012-13.

ABx1 26 requires that former RDA assets not otherwise encumbered or reserved for legally authorized purposes be distributed to the affected taxing entities in the same manner as property tax revenues but provides no deadlines for distribution.

Proposal to Balance the Budget:

- The May Revision proposes legislation that creates a framework for successor agencies to transfer cash assets not obligated or reserved for legally authorized purposes to cities, counties, special districts, and K-14 schools in 2012-13. These funds will be allocated consistent with the State Constitution. The May Revision estimates that $2 billion will flow to K-14 schools and offset the state's Proposition 98 General Fund obligation. The May Revision estimates this amount will flow to schools over two years, with $1.4 billion received in 2012-13 and $600 million received in 2013-14. The May Revision proposes that K-14 schools be authorized to retain an additional 5 percent of the amount received (or $105 million) above the Proposition 98 guarantee for discretionary purposes.

Department of Food and Agriculture

The California Department of Food and Agriculture (CDFA) protects the safety and quality of the food supply and promotes California's agricultural industry. The May Revision includes approximately $62.5 million General Fund for a number of programs, such as agricultural plant and animal health, pest prevention, and food safety services.

Proposal to Balance the Budget:

- *Reduce General Fund Support*—A permanent, unallocated reduction of $2.5 million. This builds on the $31 million General Fund reduction already adopted, which primarily affects various programs relating to border control stations, pest prevention, and food safety activities. The CDFA will collaborate with its stakeholders to prioritize its resources in determining which programs will be reduced to achieve the additional $2.5 million savings.

Department of Justice

As chief law officer of the state, the Attorney General has the responsibility to see that the laws of California are uniformly and adequately enforced. This responsibility is fulfilled through the diverse programs of the Department of Justice (DOJ).

Proposals to Balance the Budget:

- *National Mortgage Settlement Proceeds*—The National Mortgage Settlement stipulates that California will receive $410.6 million in discretionary funds for administrative costs and to support programs that benefit California homeowners affected by the mortgage and foreclosure crisis and other consumers. The May Revision proposes trailer bill language to support the following programs:
    - $41.1 million paid as a civil penalty into the Unfair Competition Law Fund to offset the costs of various DOJ programs.
    - $44.9 million to support the DOJ's Public Rights and Law Enforcement programs relating to public protection and consumer fraud enforcement and litigation.
    - $8.2 million for the Department of Fair Employment and Housing's ongoing efforts to prevent and eliminate unlawful discrimination in housing and the prosecution of violations under the Fair Employment and Housing Act.
    - $198 million to offset General Fund costs for housing bond debt service for those programs funded with Proposition 46 and Proposition 1C housing bonds that assist homeowners.
    - The remaining $118.4 million will be reserved for similar uses in 2013-14.
- *DNA Identification Fund*—A decrease of $10 million General Fund through the elimination of the General Fund transfer to the DNA Identification Fund. The May Revision proposes to replace this funding by increasing the penalty assessment by $1 for every $10 of base fine. Revenues to the DNA Identification Fund have not come in as projected; therefore, these changes are necessary to

ensure the DNA and regional forensic laboratories are able to continue performing critical public safety work.

Employment Development Department

The Employment Development Department (EDD) administers the Unemployment Insurance (UI), Disability Insurance, and Paid Family Leave programs and collects payroll taxes from employers, including the Personal Income Tax. The EDD connects job seekers with employers through a variety of job services programs and at one-stop service centers, and provides employment training programs through the Employment Training Panel and the Workforce Investment Act of 1998. To support the EDD, the Budget includes $18.4 billion ($334.3 million General Fund) and 9,953.5 positions.

Proposal to Balance the Budget:

- *Unemployment Interest Payment*—The Governor's Budget includes a loan of $417 million from the Unemployment Compensation Disability Fund (DI Fund) to the General Fund to pay for the UI interest to the federal government. Since the Governor's Budget, the federal government lowered the interest rate on funds borrowed, resulting in a decrease of $104.4 million in 2012-13 to reflect a reduction to the loan from the DI Fund to the General Fund.

Other Significant Adjustments:

- *Unemployment Insurance Benefits*—An Unemployment Fund increase of $895.7 million in fiscal year 2011-12 and an increase of $4.3 billion in 2012-13 for UI benefit payments, primarily because of the enactment of additional federal benefit extensions. With these adjustments, total benefit payments will be $16.4 billion in 2011-12 and $11.1 billion in anticipated benefits for 2012-13.
- *Unemployment Insurance Modernization Project*—An increase of $16.9 million ($11.6 million Contingent Fund and $5.3 million federal funds) and a redirection of $6.3 million UI Administration Fund in 2012-13 to provide continued support for the Unemployment Insurance Modernization Project.
- *Disability Insurance Automation Project*—An increase of $33.8 million Unemployment Compensation Disability Fund in 2012-13 to provide continued support for the Disability Insurance Automation Project.

State Appropriations Limit Calculation

2012-13 State Appropriations Limit Calculation—Pursuant to Article XIIIB of the California Constitution, the 2012-13 State Appropriations Limit (SAL) is estimated to be $84.452 billion. The revised limit is the result of applying the growth factor of 4.32 percent. The revised 2012-13 limit is $33 million below the $84.485 billion estimated in January. This decrease is due to changes in the following factors and shifts in financial responsibility

- Per Capita Personal Income
    - January Percentage Growth: 3.69%
    - May Revision Percentage Growth: 3.77%
- State Civilian Population
    - January Percentage Growth: 0.84%
    - May Revision Percentage Growth: 0.68%
- K-14 Average Daily Attendance
    - January Percentage Growth: 0.29%
    - May Revision Percentage Growth: 0.29%

For SAL purposes, per capita personal income is defined as calendar fourth quarter California personal income, as estimated by the US Bureau of Economic Analysis (BEA), divided by California civilian population, estimated by the California Department of Finance. Since BEA does not release its personal income estimate until April, the Department of Finance uses its own estimate for the Governor's Budget in January. The May Revision reflects the BEA's estimate of California personal income.

Debt Service

Budget Year Debt Service—General Fund debt service expenditures will decrease by $162.5 million, to a total of $5.2 billion. This is comprised of a decrease of $158 million for General Obligation debt service ($4.5 billion total) and a decrease of $4.5 million for lease revenue bonds ($741.1 million total). The decrease in General Fund costs reflects the proposed solution to use $92.1 million from a recent mortgage settlement to offset targeted housing debt service costs and $65.9 million in savings related to workload adjustments. The workload savings can be mainly attributed to a smaller spring 2012 bond sale ($1.468 billion lower than projected), a slightly lower projected estimate for the fall 2012 bond sale, and savings related to refinancing previously issued bonds with lower-cost bonds. The decrease in the size of the spring 2012 bond sale was accomplished by using existing bond cash more efficiently. In an effort to minimize unnecessary costs, the Department of Finance will continue to work with departments to better manage bond cash and ensure additional bonds are issued only when necessary. Progress has already been made, as the balance of unspent bond proceeds available from previous bond sales has been reduced to approximately $7.3 billion, as of April 30, 2012, as compared to $9.5 billion, as of December 2011.

Current Year Debt Service — General Fund debt service expenditures will decrease by $172.8 million, for a total of $5.2 billion. This is comprised of a decrease of $159.2 million for General Obligation debt service ($4.5 billion total) and a decrease of $13.6 million for lease revenue bonds ($670.9 million total). The decrease in General Fund costs reflects the proposed solution to use $105.9 million from the mortgage settlement to offset targeted housing debt service costs (noted above) and $53.3 million in net savings related to various workload adjustments, including the use of $16.3 million in excess bond proceeds from various closed bond accounts to offset debt service.

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