CALIFORNIA
Senate
Republican Caucus

Highlights and Analysis of the 2012-13 Budget

July 18, 2012
SENATE REPUBLICAN FISCAL OFFICE

Table of Contents

Budget Briefs

SENATE REPUBLICAN FISCAL OFFICE

Highlights & Analysis of the 2012-13 Budget

July 18,2012

Executive Summary

In July 2011, the Governor and legislative Democrats asserted that their “honest and balanced” majority-vote budget closed a $26.6 billion budget gap, and reduced the structural budget gap for fiscal year 2012-13 to $3.1 billion. Now, they claim to have closed a $15.7 billion budget gap (far larger than the previously noted $3.1 billion), and enacted a budget that would be “balanced on an ongoing basis for the first time in a decade.” In reality, the 2012-13 state budget is about 90 percent gimmicks (e.g., borrowing, fund shifts, and payment deferrals) and 10 percent real programmatic spending reductions. Unfortunately, it is no different than the other gimmick filled budgets of the past decade and it is almost certain that another budget deficit will emerge within six months – likely sooner.

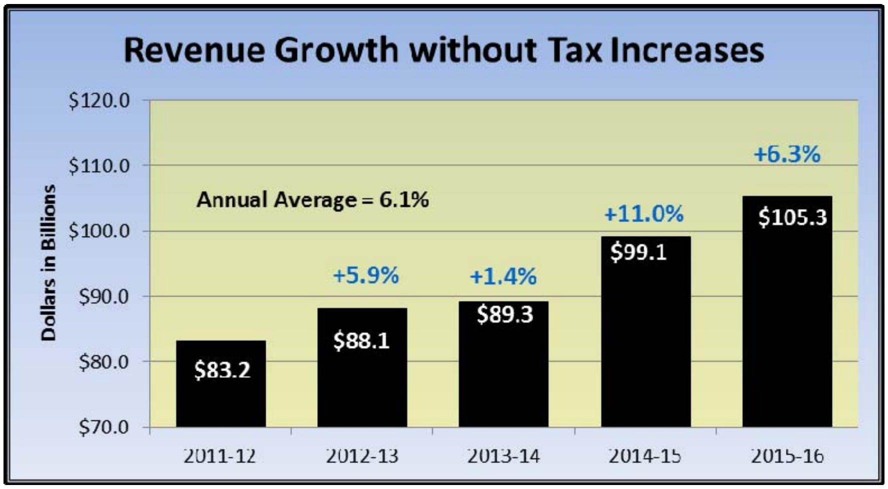
The Governor says that this state budget plan is balanced with a $1 billion reserve. He claims his solutions include $8.1 billion of expenditure reductions; $6 billion in new tax increases and other revenues and $2.5 billion of “other” solutions (primarily special fund loans and transfers). However, a closer review of these solutions reveals that the new state budget plan reflects only about $1.4 billion of real state program spending reductions (the other items, have no programmatic impact such as natural program caseload changes or not providing cost of living increases). Additionally, over $4 billion of the Governor’s so-called “expenditure reductions” are actually loans, fund shifts, and deferrals such as:

1) $1.5 billion shift of Redevelopment Agency (RDA) assets,
2) $525 million fund shift of trial court reserves,
3) $390 million fund shift of mortgage settlement proceeds,
4) $660 million deferral of Medi-Cal provider payments, and
5) $830 million to defer/repeal state mandates.

The lynchpin for the entire state budget is a scheme to coerce voters into supporting a seven-year, $47 billion tax increase by threatening to make $6 billion in “trigger reductions” to K-14 and higher education programs. However, it is unlikely that those spending cuts will actually be implemented if the tax increase fails at the ballot – much like the trigger reductions included in last year’s state budget plan were unachievable and did not occur.

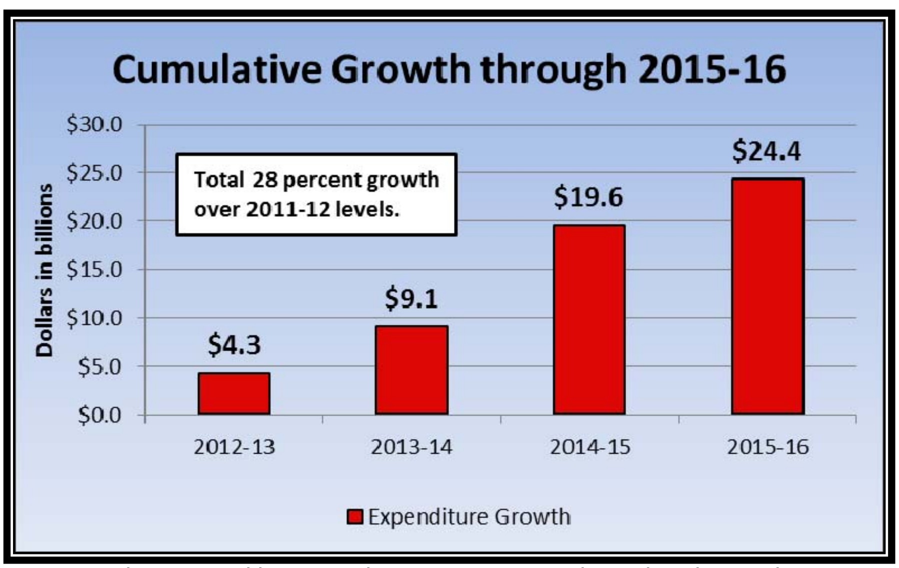
Key Points:

Robust Revenue Growth. State revenues are projected to **grow by nearly $5 billion** from 2011-12 to 2012-13 **without the Governor’s proposed sales and income tax increases**. The following chart reflects the baseline revenue projections without the Governor’s tax increase initiative through 2015-16. The simple story told by this chart is the strength of General Fund revenue growth projected in the out years, ***even without tax increases.*** Average annual revenue growth over the forecast period (6.1 percent) actually ***exceeds*** historic revenue growth over the past 30 years of about 5.1 percent.



Source: DOF Budget Act Multi-year Back-up Document- "Problem Definition"

Substantial Spending Growth. General Fund expenditures grow by $4.3 billion (from $87.0 billion to $91.3 billion) in 2012-13 (*see detail Expenditures on Page 13*). **This equates to a 4.9 percent growth in expenditures at the same time the Governor believes an $8.5 billion tax increase is necessary to balance the state budget**. In fact, according to the Governor's projections, his proposed sales and income tax increase will **fund a $24.4 billion (28 percent) state spending increase** by 2015-16 (*see chart below*). Cumulatively, the Governor's proposed tax increase generates $47 billion of revenue over seven years while state spending increases by $57.4 billion over four years. Effectively, this budget plan would increase state spending by an amount substantially greater than the tax increase revenues. Fundamentally, you can't balance the budget, even with tax increases, if the money is spent faster than it comes in.

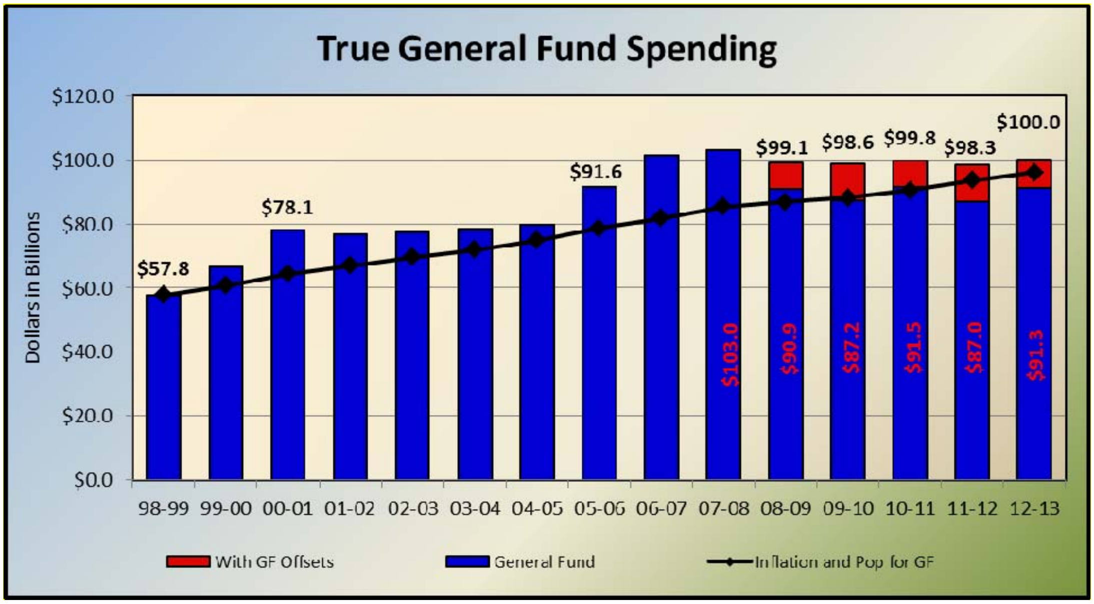


Source: DOF Budget Act Multi-year Back-up Document- "Balanced Budget and Pay Down Debt"

True General Fund Program Spending. Legislative Democrats frequently claim that state spending has been slashed by $40 billion. This claim is based upon an old projection from the 2008-09 Governor's Budget that suggested spending, unchecked, would grow to about $124.5 billion by 2011-12. Since current year General Fund spending is now $87.0 billion, they calculate that spending is almost $40 billion lower than it should have been if it had continued growing at a record pace. This This logic is faulty at best. The reality is that state General Fund spending peaked in 2007-08 at

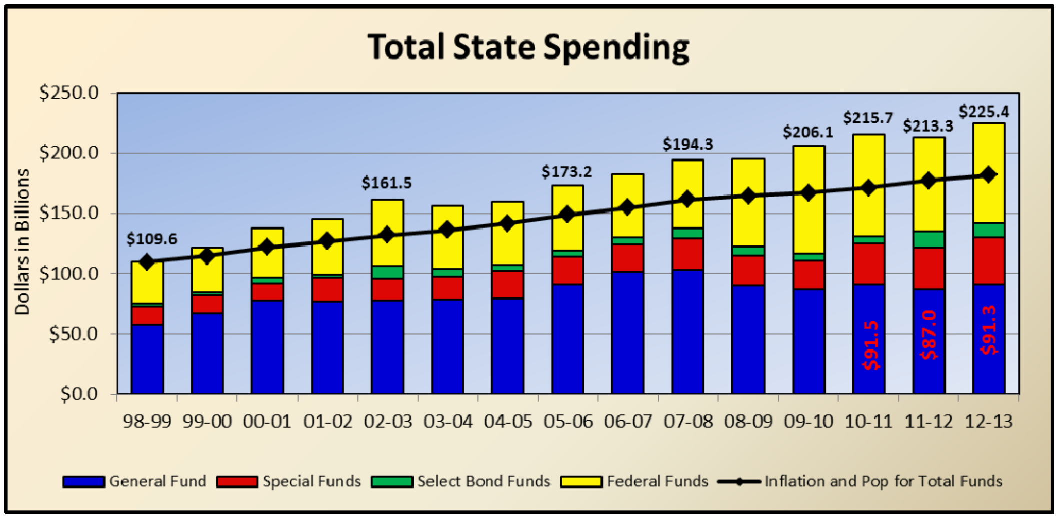
$103 billion and various accounting gimmicks, borrowing and fund shifts have effectively allowed the state to maintain General Fund program spending at around the $100 billion level each year since spending peaked in 2007-08. The 2012-13 budget plan includes a $5.9 billion shift of funds associated with Governor's Realignment scheme, $3.2 billion from Redevelopment Agency funds, plus about $4 billion of other fund shifts that backfill General Fund programs, such AB 32 fees, trial court reserve fund, federal funds, and transportation weight fees. Once these General Fund-like program expenditures are added to the other $91.3 billion in 2012-13 expenditures, it becomes clear that state General Fund program spending hasn't been reduced much at all.

As noted in the chart below, the "true" underlying General Fund expenditure level (red bar), which recognizes the "offsets" discussed above, shows that actual General Fund-like spending continues to hover around the $100 billion mark and is 4.0 percent greater than population and inflation growth.



Source: (1) Department of Finance Schedule 9, (2) LAO - February 17, 2012 Letter to Senator Huff regarding Underlying State Spending, (3) DOF Chart H

Total State Spending. Under the 2012-13 budget plan, **total state spending will have increased by $31.1 billion since the "great recession" began after 2007-08**. General Fund spending tends to be the focus of state budget conversations, but it can be misleading because of all the fund shifts and "budgetary backfills" that have occurred but are not reflected in General Fund spending totals. As the chart on the next page demonstrates, total state spending from all fund sources continues to far outpace population and inflation. Even with the recent recession, the proposed 2012-13 spending level still exceeds population and inflation growth by $43.3 billion ($182.1 billion vs. $225.4 billion). The Governor and legislative Democrats argue that state spending has been *drastically reduced* in the wake of the "great recession," but the truth is that California continues to spend significantly more than it did before the recent economic downturn (*$194 billion in 2007-08 compared to $225 billion proposed for 2012-13*) when General Fund spending peaked at $103 billion.



Source: Department of Finance Schedule 9

No Credibility on Trigger Cuts. Last year's budget included $2.5 billion of trigger reductions that were supposed to occur if revenues fell $4 billion short. Well, revenues fell short of projections by more than $5 billion, yet less than $1 billion of trigger cuts actually occurred. Now, the Governor is using California students as hostages to force voters to support his seven-year, $46.8 billion tax increase. Of the proposed $6 billion of new trigger cuts, almost 99 percent of those reductions are targeted at K-14 and Higher Education (*see Trigger reductions on Page 49*). However, it is difficult to believe that the Governor will not find a new "trap door" to avoid those reductions. More notable is that legislative Democrats refused to adopt the Governor's reductions to welfare programs, but have not acted to protect California students. In March 2012, and again in June 2012, **Republicans proposed alternative budget solutions to avoid reductions to vital education programs and stop college tuition/fee increases, but legislative Democrats rejected those alternative proposals.**

Governor's Tax Increase Provides Little Help for Schools. Under this budget plan, state programmatic funding for K-14 education would remain roughly flat from 2011-12 to 2012-13 despite raising taxes by $8.5 billion. Only one-third ($2.9 billion) of the new tax revenues would be used for school funding while the tax initiative also shifts about $2.4 billion of existing funds (sales tax revenue) that would have gone to education to instead support his local public safety realignment scheme. Thus***, the tax initiative appears to provide little benefit to school funding.*** Of course, the Governor threatens to cut K-14 school funding by $5.4 billion if voters don't approve his sales and income tax increases.

HFP Shift Hurts Kids and Costs More. Rather than standing his ground for real spending reductions and pension reform, the Governor settled for promises of future reductions and an ill-advised shift of 880,000 children currently enrolled in the Healthy Families Program (HFP) into Medi-Cal. Legislative Republicans, health care advocates, health plans, and health care providers all opposed this transfer of HFP children because of concerns that such a transfer will threaten access and continuity of care. Currently, eligible Californians can sign up for Healthy Families through a private vendor for an average state administrative cost of about $50 per beneficiary, but under the new shift to Medi-Cal, public employees will now be in charge of eligibility processing, which increases the administrative costs to nearly $300 per beneficiary. **This plan prioritizes public employee jobs over children's health care**.

Spending Not at 1970's Levels. The Governor and legislative Democrats have been throwing around statistics to fool Californians into believing state spending per $100 of personal income is at the lowest level since the 1970's. The truth is that for all state fund sources, at nearly $8 per $100 of personal income, ***it is higher than it was in 2008-09*** and is entirely in line with historic norms.

Budgetary Threats Thrive. The 2012-13 budget is wrought with optimistic assumptions that will undermine the integrity of the plan. Optimistically, **the budget is probably out of balance by at least $2 billion**, and that deficit could easily be triple that amount ($6 billion) depending on the dubious trigger reductions, as well as the optimistic tax and RDA revenue assumptions. Some of the most notable threats to this budget package include:

- **Neither Taxes Nor Trigger Cuts** – The budget relies on voter approval of the Governor's tax initiative in November 2012 to provide $8.5 billion of revenues in 2011-12 and 2012-13. Voters have rejected each of last eight tax hikes presented to them in statewide elections. **There is good reason to doubt the $6 billion of proposed "trigger reductions" will occur** if/when the current tax initiative is rejected. If the trigger reductions do occur, the $5.5 billion cut to K-14 education includes $3.1 billion of programmatic reductions, which could throw some districts into fiscal insolvency, in which case the General Fund would have to provide emergency loans that could easily run into the hundreds of millions of dollars, or more.
- **LAO Revenue Estimates Lower Than Governor** – Even if the voters approve the Governor's tax initiative, the LAO estimates that the initiative would only generate about $6.8 billion of revenues in 2011-12 and 2012-13 (Governor assumes $8.5 billion). If the LAO is correct, this revenue shortfall **would create a $1.7 billion budget deficit**.
- **Estate (Death) Tax Flip-Flop** – The budget plan now assumes that California will receive revenues from the estate (death) tax, which is a change from the Governor's May Revision assumption that these revenues would not be available. The LAO advised the Legislature "to assume no such revenues during its 2012-13 budget process unless there is a clear indication from Congress that a state death tax credit will be adopted" which would allow for the resumption of the state-level estate tax. If the estate tax revenues do not materialize, the Governor's budget forecast will fall apart, and resulting **state operating deficits would be at least $262 million in 2013-14, $584 million in 2014-15, and $830 million in 2015-16**.
- **Managed Care Tax Revenues Not Extended**. The budget relies on revenues from the Medi-Cal managed care organization (MCO) tax for **$183 million in General Fund savings, but that tax expired June 30, 2012**, and has not been extended. Republicans and health care plans previously supported the tax because it helped fund the Healthy Families Program (HFP). However, because the partisan state budget eliminates the popular and successful HFP it violates an agreement that revenues from the MCO tax be used only to support and maintain the HFP, which was the original basis for Republican and health plan support of the tax. Legislative Democrats intend to seek a tax extension through policy legislation in August 2012, but Republicans support for this tax increase has traditionally been conditioned on the funds being used for the HFP, and it is unlikely there will be any support for what is now just another General Fund tax increase that will be used to fund state employee health and pension benefit cost increases and welfare benefits.
- **RDA Property Taxes Overstated** – The Department of Finance notified the Legislature that the reserve will be at least $122 million lower than expected as a result of property tax revenues from Redevelopment Agencies coming in lower than expected. The Legislative Analyst's Office (LAO) had previously cautioned that the budget assumptions regarding **property tax revenues from Redevelopment Agencies are likely overstated by $900 million**.
- **RDA Litigation** – The LAO has also raised concerns that the $1.5 billion of liquid assets to be distributed to schools is **"subject to considerable uncertainty"** given the "likelihood that lawsuits will delay distribution of these funds."
- **Facebook IPO –** The budget relies on $1.9 billion of revenues related to this IPO (based on a $35/share price), however, stock performance has been lackluster at best. When the stock market closed on June 29, Facebook closed with a price of $31.09/share. Consistent with caution provided by the LAO, which warned that revenues could be higher or lower by several hundreds of millions of dollars, a share price that is 11 percent lower than estimates **could reduce revenues by more than $200 million**.

Conclusion

The Governor has failed. This is a failed budget plan. The 2012-13 state budget is essentially a continuation of past budget models, as the "solutions" consist of about 90 percent ($15.1 billion) gimmicks, and only 10 percent ($1.4 billion) actual program spending reductions. **It does not include real public employee pension reform** to address those unsustainable costs nor any job creation measures to help the two million unemployed Californians. It does, however, include plenty of "giveaways" to public employee unions that will drive up state costs in the future *(see Union Giveaways page 8)*. As noted above, General Fund program spending has not been significantly reduced and **total state spending is proposed to reach a new record high of over $225 billion**. In addition, his $47 billion seven-year tax increase plan fuels a $57.4 billion four-year spending increase, which demonstrates that the Governor and legislative Democrats plan to spend money faster than they can raise taxes.

Furthermore, the Governor's tax increase proposal does not provide additional funding for K-14 education programs, but he does use school children as hostages by targeting education programs for 99 percent of his trigger cuts. Voters will see through this **"hostage taking"** approach and recognize that the money is really being used to fund future government growth, not reduce college fees or protect classroom funding.

The Governor has failed to get his fellow legislative Democrats to make meaningful spending reductions and adopt necessary pension reforms. **This partisan majority-vote budget reflects their priorities for protecting public employees**. It eliminates a successful and cost-effective health insurance program that had bi-partisan support (Healthy Families) in order to increase public employee jobs, and targets students, teachers and local education communities for almost all of the trigger spending reductions. The budget plan grows state spending to record levels while still attempting to burden Californians with a massive new tax increase to fuel future spending growth. It includes overly optimistic revenue and savings assumptions that will likely result in yet another multi-billion budget deficit. **This is not an honest and balanced budget that will put California on track to fiscal and economic health – it is a failed partisan budget plan that will swiftly unravel.**

Union Giveaways in Budget Plan

It's pretty clear who the winner in the 2012-13 state budget is, and it is not California students, taxpayers, or beneficiaries of state services. But, public employee unions have plenty to celebrate. Here are some examples of the recent changes that will increase the union domination of California state government:

- The Governor proposed to allow the state Department of Transportation to save money by using additional contracted staff, consistent with voter approved Proposition 35 (2000). However, Legislative Democrat's rejected the Governor's plan to better manage state and private sector workload in order to control short and long-term state costs. The Governor approved the budget despite the fact that it maintains the inherent imbalance and inefficiency at the Department of Transportation.

- The Administration stated in the May Revision that it intends to further restrict the state's ability to achieve personnel savings by focusing less on contracting out for low cost workers for information technology and personal services, such as janitorial and security services.

- The recently negotiated Memorandum of Understanding (MOU) between the Administration and Service Employees International Union (SEIU) would now have the Governor discontinue use of "non-represented" student aides/assistants and retired annuitants while working hand-in-hand with SEIU to identify and reduce the number of state (non-union) contracts. The most devious part of this little scheme is that in the unlikely event any savings are actually achieved, SEIU would be allowed to help determine how those savings should be spent. To add insult to injury, the practical elimination of all non-union elements of state government could be long lasting, while the MOU's furlough savings are only in place for one year.

- The elimination of the Healthy Families Program (HFP) not only will end a successful program for providing health care to children in working families, it also will provide another bonus to unions at potentially far greater cost to the state. The HFP employs one state worker for every 13,000 enrollees, nearly 4.5 times more efficient than Medi-Cal, which employs one state worker for every 2,900 enrollees. The HFP outsources administration of their eligibility and enrollment functions to a private vendor, but Medi-Cal uses public employees at county welfare offices. The HFP vendor costs $49 per child per year, while costs for county welfare workers average $294 per person per year in Medi-Cal. This budget takes the job of administering enrollment for 880,000 HFP children away from the more efficient private contractor and hands it over to county welfare workers. If the new costs reach the Medi-Cal average, the state will be forced to spend an additional $213 million total funds ($75 million General Fund) for an inferior state health program.

- Another favor to the Public Employee Unions is the new requirement for a statewide collective bargaining process for In-Home Supportive Service (IHSS) workers as part of the Coordinated Care Initiative, which will lead to even higher costs as it will result in providing the highest compensation level in all pilot project counties rather than individual counties trying to achieve the best price for services based on local needs and costs.

Employee Compensation

Pay Cut or Loan. The 2012 Budget includes savings of $840 million ($402 million General Fund) to be achieved through collective bargaining. The Governor currently has negotiated agreements with most of the state's 21 bargaining units for a one day per month unpaid Personal Leave Program (PLP). Bargaining units without agreements will be subject to the same level of savings through either a negotiated agreement or through furloughs. State employees will see their pay reduced by 4.6 percent for 2012-13 only, the equivalent of eight hours of pay per month, and will be authorized to take a personal leave day in return. The Highway Patrol members will be allowed to bank leave credits and can take them at any time, including saving them and cashing them out upon retirement. This proposal will not achieve long-term savings for the state and doesn't reduce employee compensation in real terms, simply requires state employees to work one less day a month, and reduces their pay accordingly. Since most state employees will use these unpaid days off in lieu of vacation days, this is essentially an interest bearing loan that will be repaid when the employees cash out vacation days at higher salary levels in the future.

State Employee Salary Increases. According to the State Controller's Office, and assuming 2012-13 merit salary adjustments (MSAs) are consistent with past years, MSAs have increased baseline state spending on state employee wages by more than $800 million, cumulatively costing the state $3.5 billion, since 2005-06. Merit salary adjustments are automatic salary increases, and are not affected by furloughs or personal leave programs. Without civil service reform, the state will continue to give automatic salary increases regardless of job performance or fiscal circumstances. The state can no longer afford to do business this way, annual pay increases must not be considered an entitlement for public employees.

Extends MOU's Until 2013. The 2012 Budget also ratifies the addenda to extend the contract with Bargaining Units (BUs) 12 (International Union of Operating Engineers), 16 (Union of American Physicians and Dentists), 18 (California Association of Psychiatric Technicians), and 19 (American Federation of State, County and Municipal Employees) through July 1, 2013. For BUs 12 and 18, this action increases health premium rates, and **will cost the state $18.7 million total funds ($5.9 million General Fund).**

Public Employee Retirement Benefits.

The 2012 Budget includes $2.4 billion General Fund ($4.3 billion all funds) for state contributions to the California Public Employees Retirement System (CalPERS). The increased contribution levels ($350 million more General Fund than 2011) are a result of various factors including higher than expected retirement rates and the CalPERS' Board decision to decrease the assumed rate of investment return to 7.5 percent from 7.75 percent. Although the Board has voted to phase in the cost to the state as a result of the investment rate change, the legislature took action to fully fund the difference in 2012-13. The budget includes $304.1 million total funds ($173 million General Fund) in additional state retirement contributions for this adjustment.

Growth in State Employees

The Governor's May Revision proclaimed that more than 15,000 state employee positions were eliminated in 2011-12 through budget reductions. Additionally, the May Revision indicated a review of historical vacancies identified an additional 11,000 positions that will be permanently eliminated in 2012-13. Including all reductions proposed in the 2012-13 budget, the Brown Administration claims that it will have achieved a total reduction of more than 30,000 state employee positions.

A review of budget documents, however, shows that **this claim is nothing more than funny "budget math."** Information provided by the Governor's Department of Finance shows personnel years have **not** been reduced by 30,000, but they have actually **increased by 138.5 since Governor Brown took office after Governor Schwarzenegger in 2010-11 .** In fact, if state employee positions for higher education are not included in the overall number (the Governor has no authority over these positions and is not directly responsible for increasing or decreasing positions), **the actual increase in state employee positions is 4,680.2 in 2012-13 compared to 2010-11**. The chart below compares personnel years from 2010-11 to the Governor's projection for 2012-13, including a distinction at the bottom if higher education is not included in the numbers.

Personnel Years by Agency

Agency	2010-11	2011-12	2012-13	Change in Positions 12-13 to 10-11	Percentage Change 12-13 to 10-11
State and Consumer Services	16405.4	16107.2	16951.9	546.5	4%
Business, Transportation, and Housing	40167.6	42672.3	42713.9	2,546.3	6%
Resources	18254.3	18394.9	18478	223.7	1%
Environmental Protection	4191.7	4234.3	4219.9	28.2	1%
Health and Human Services	28572.3	30489.3	30298.1	1,725.8	6%
Youth and Adult Correctional	57920.9	61160.1	58598.8	677.9	2%
K-12	2,663.7	2,782.4	2,767.6	103.9	4%
Higher Education	129,661.9	125,064.6	125,020.2	-4,641.7	-4%
Labor and Workforce Development	13736.6	12865.3	12847.9	-888.7	-6%
Other (Gen Govt, Legislative, Judicial, Executive)	30,702.9	30,135.2	30,120.6	-582.3	-2%
Total	340,967.8	343,793.6	341,106.3	138.5	0.04%
Higher Education	-129661.9	-125064.6	-125020.2	4,641.7	-4%
Total without Higher Education	211,405.9	218,712.0	216,086.1	4,680.2	2.21%

[illegible]

[illegible]

Department of Finance Chart ? -1

Revenues

The 2012-13 Budget Act assumes total General Fund revenues and transfers of approximately $95.9 billion for 2012-13, which is up from $86.8 billion for 2011-12 (10.4 percent year-over-year increase). This year-over-year increase reflects both strong baseline revenue growth in 2012-13 for all three major taxes (Personal Income, Sales, and Corporate) and the Governor's proposed tax initiative (scheduled for November 2012). Baseline General Fund revenues are projected to increase by $4.9 billion (from 2011-12 to 2012-13) even without increasing taxes. And, the budget relies on more than $11 billion of new "revenues," including about $8.5 billion of new revenue from the Governor's tax initiative proposal and about $2.6 billion of transfers and other revenues (mostly transfers and borrowing from special funds).

These amounts do not include tax revenues (1.0625 percent of the state sales and use tax (SUT)) that were redirected to local governments as a part of the 2011 Public Safety Realignment proposal ($5.1 billion in 2011-12 and $5.4 billion in 2012-13).

In reviewing revenues relied upon by the 2012-13 Budget Act, there are at least two issues that would threaten anticipated levels of revenues:

- **Taxes on the Ballot.** Though a tax increase is not included the budget bill, or any of the related trailer bills, the budget relies on voters approving a seven-year, $47 billion tax increase. History has shown that when competing tax hikes land on the ballot California voters tend to vote NO on all of them. In fact, voters have rejected each of the last eight tax hikes presented to them:

Election	Initiative	Title	No Vote
June 2006	Proposition 82	Universal Preschool	60.8 percent
November 2006	Proposition 86	Tobacco Tax	51.7 percent
November 2006	Proposition 87	Oil Severance Tax	54.6 percent
November 2006	Proposition 88	$50 parcel tax	76.7 percent
May 2009	Proposition 1A	Extend Temporary Tax Increases	65.4 percent
November 2010	Proposition 21	Car Tax for State Parks	57.3 percent
November 2010	Proposition 24	Repeal Single Sales Factor	58.1 percent
June 2012	Proposition 29	Cigarette Tax For Research	50.3 percent

  If the Governor's tax initiative fails on the November 2012 ballot, the Budget Act includes provisions to implement $6 billion of trigger reductions *(discussed in more detail in Trigger Reductions on page 49).*

- **Weakness in Facebook Projections.** The May Revision included increased General Fund revenues of $500 million in 2011-12 and $1.4 billion in 2012-13 that were anticipated to materialize with the initial public offering (IPO) of Facebook, Inc. The Legislative Analyst's Office indicated that revenues could be significantly higher or lower, based on a variety of unknowns at the time, but projected that the Facebook IPO would yield an additional $500 million in 2011-12 and $1.6 billion in 2012-13. Both organizations estimated an initial share price of $35, but differed on their estimate of the share price in six months ($35/share-Finance; $45/share-LAO) when a large volume of "restricted stock unit" settlement activity is scheduled to occur. Though Facebook opened at $38 on May 18, 2012, performance since then has been disappointing. On June 29, 2012 when the stock market closed, Facebook closed with a price of $31.09/share. To the extent Facebook's share price does not improve significantly, both estimates from Finance and the LAO are likely overstated.

In addition to the issues noted above, the 2012-13 Budget Act includes three tax policy issues that will affect taxpayers in California:

- **Expand Financial Institutions Records Match (FIRM).** Expands the Franchise Tax Board's (FTB) authority to match financial institutions customer records against FTB debtor records to match records at the Board of Equalization and the Employment Development Department. This change is expected to generate $4 million General Fund revenue in 2011-12 and $11 million General Fund revenue in 2012-13.

- **Change Rules Regarding Wage Garnishment.** Allows the FTB to issue a wage garnishment against delinquent income tax debt without requiring FTB to record a tax lien. This change is expected to generate $11 million General Fund revenue in 2011-12 and $27 million General Fund revenue in 2012-13. The intent of these provisions is intended to remove an incentive for FTB to record a lien (benefitting taxpayers) prior to garnishing wages to collect tax debts.

- **Repeals Memberships in Multi-state Tax Compact (MTC).** Repeals the statutes that establish California's participation in the MTC. Specifies that the "doctrine of election" means that an election affecting the computation of tax must be made on an original timely filed return for the taxable period for which the election is to apply and once made is binding, and that this is declaratory of existing law. Cautions that the repeal of the Multi-state Tax Compact should not be interpreted as a declarative change related to the interpretation of existing law.

Budgetary Borrowing. The Governor's "wall of debt" continues to loom over the state as a problem that needs to be addressed. As of June 30, 2012, the "wall of debt" is estimated to be $34.2 billion.

	6/30/2012 Balance	**2012-13 Impact**
Deferred Payments to Schools and Community Colleges	$10,430	$2,225
Economic Recovery Bonds	$6,263	$1,349
Loans from Special Funds	$4,290	$181
Unpaid Mandate Costs-Schools, Local Governments, Community Colleges	$5,055	$0
Underfunding of Proposition 98	$2,756	$0
Borrowing from Local Government (Prop 1A)	$2,095	$2,095
Deferred Medi-Cal Costs	$1,659	$0
Deferral of State Payroll Costs from June to July	$759	$0
Deferred Payments to CalPERS	$524	$0
Borrowing from Transportation Funds (Proposition 42)	$334	$83
Total	**$34,165**	**$5,933**

** Budget Act – high level support documents*

This table reflects a 17.3 percent reduction to the "wall of debt" in 2012-13, half of which should be credited to voter wisdom. However, the back story of this table is more interesting:

- Repayment of the Proposition 1A (2004) borrowing (property taxes) from local governments is on "auto-pilot" as repayment is required by the Constitution prior to June 30, 2013.

- Repayment of the Economic Recovery Bonds is on "auto-pilot" as one-quarter of one percent of the state sales and use tax is dedicated to repaying those bonds, pursuant to Proposition 57 (2004).

The Governor can claim that he reduced education deferrals, but only if voters approve his proposed tax initiative. And, it's important to note that repaying $181 million of loans from a variety of special funds is eclipsed by the fact that the budget relies on delaying the repayment of $1.1 billion of loans from 44 special funds.

Expenditures

The 2012-13 budget includes total General Fund expenditures of $87 billion in 2011-12 (about $1.1 billion higher than the 2011 Budget Act) and $91.3 billion in 2012-13 (about $5.4 billion higher than the 2011-12 Budget Act). Keep in mind that expenditure levels identified below for 2011-12 and 2012-13 assume voter approval of the Governor's tax increase initiative that is slated for the ballot in November 2012 (discussed in the previous section). If voters do not approve the Governor's tax initiative in November, K-12 Education expenditures will be decreased by about $5.4 billion and Higher Education (UC & CSU) expenditures will be reduced by $500 million (98.4 percent of the total Trigger Reductions). *Additional information regarding Trigger Reductions can be found on page 49.*

General Fund Expenditures By Agency

(dollars in millions)

Agency	2011-12 Budget Act	2011-12 Revised		2012-13 Budget Act
Legislative, Judicial, Executive	$3,151	$2,541		$2,056
State and Consumer Services	$624	$619		$689
Bus, Trans, and Housing	$603	$573		$448
Resources	$1,946	$1,948		$1,900
Environmental Protection	$51	$51		$46
Health and Human Services	$23,043	$26,772		$26,695
Corrections and Rehabilitation	$9,821	$8,060		$8,887
K-12 Education	$34,302	$34,497		$37,848
Higher Education	$10,248	$9,887		$9,432
Labor and Workforce Development	$371	$354		$342
General Government	$1,465	$443		$487
Other/Statewide Savings/Expenditures*	$312	$1,281		$2,508
Total, General Fund Expenditures	**$85,937**	**$87,026**		**$91,338**
Change since 2011-12 Budget Act		$1,089		$5,401
- As a Percentage		**1.3%**		**6.3%**

Department of Finance – Schedule 9

** The Other/Statewide Savings/Expenditures category includes a variety of statewide proposals that have not yet been allocated to specific departments or programs, including the Prop 1A loan repayment to locals, employee compensation reductions, health and dental benefits for annuitants, the PERS deferral, and assumptions for federal fund offsets related to health and human services programs.*

General Fund spending is only a part of total state spending. Including special funds, bond funds, and federal funds, total state spending for 2012-13 is projected to be $225.4 billion. This level of total state expenditures is $12.1 billion higher than total expenditures in 2011-12 ($213.3 billion). Despite the great recession and Democrats' claims of "cutting to the bone," total state spending remains at record high levels. Total state spending is near all-time highs as a result of the proposed tax increase, fund shifts, federal funds, and General Fund offsets such as the "realignment" scheme. Expenditures per $100 of personal income are consistent with historic norms at about $7.73.

True state General Fund program spending, which accounts for fund shifts, transfers, and General Fund offsets - remains near $100 billion (only 2.9 percent less than peak General Fund spending in 2007-08). This level of spending has remained consistent throughout the "Great Recession" and despite legislative Democrat claims to have reduced spending by tens of billions (*see table on next page*).

Underlying General Fund Program Spending (dollars in billions)						
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Schedule 9 Expenditures	**$103.3**	**$90.9**	**$86.6**	**$91.5**	**$87.0**	**$91.3**
"Offsets" to Maintain General Fund Program Levels*	--	$8.5	$11.5	$8.2	$11.3	$8.7
Total, General Fund Program Expenditures	**$103.0**	**$99.4**	**$98.1**	**$99.8**	**$98.3**	**$100.0**
Percentage Below Peak 2007-08 General Fund Spending		-3.4%	-4.8%	-3.1%	-4.5%	-2.9%

Department of Finance – Schedule 9

Though General Fund spending is down (compared to 2007-08), true "underlying" General Fund spending, which recognizes federal fund offsets, fund shifts, and deferrals employed to support General Fund programs, is still in excess of $98 billion for both the current and prior budget years. In addition to $91.3 billion General Fund, the 2012-13 Budget Act relies on (1) nearly $3.2 billion of property taxes from redevelopment agencies to fund education and special districts, (2) realigning $5.9 billion of public safety programs to the local level, (3) $544 million of trial court reserves to fund court costs, (4) $604 million of weight fees to pay general obligation bond debt, and (5) a variety of smaller transactions to offset General Fund reductions and maintain General Fund programs. In prior years, the Legislature has relied on additional federal funds, redevelopment agencies, inter-year Proposition 98 deferrals, employee compensation deferrals and local property tax borrowing to maintain General Fund programs in the absence of General Fund revenues.

K-14 Education

The 2012-13 budget funds the Proposition 98 guarantee of funding for K-14 education at $53.5 billion. While this might appear to be a year-over-year increase of over $6 billion, it actually provides very little new programmatic funding, as most of the additional funds are used to backfill 2011-12 one-time solutions, unwind funding deferrals, fund the Quality Education Investment Act (QEIA) program with Proposition 98 dollars, shift some existing child care slots into Proposition 98, backfill one-time Proposition 63 funds spent for special education services with Proposition 98 dollars, etc. The following chart displays the Proposition 98 funding levels scored in the final budget package:

Proposition 98 Funding at 2012-13 Budget Act

Source: Legislative Analyst's Office

($ in millions)	2010-11	2011-12	2012-13
K-12 education			
General Fund	$31,248	$29,728	$33,309
Local property tax revenue	$12,191	$11,856	$14,342
K-12 subtotal 1/	$43,439	$41,584	$47,651
California Community Colleges			
General Fund	$3,885	$3,279	$3,415
Local property tax revenue	$1,965	$1,971	$2,403
CCC subtotal	$5,850	$5,251	$5,818
Other Agencies	$87	$82	$79
Total Proposition 98 1/	$49,376	$46,916	$53,549
General Fund	$35,219	$33,089	$36,804
Local property tax revenue	$14,157	$13,827	$16,745
Prop 98 per-pupil spending (K-12)	$7,303	$6,966	$7,955

1/ $1.055 billion in child care funding was shifted out of Prop 98 as of the 2011-12 Final Budget Act

Republican plan to protect education rejected. If the voters reject the seven-year, $47 billion tax hike on the November ballot, about $6 billion in automatic 'trigger cuts' will be activated, almost $5.4 billion of which will be aimed at K-12 schools and community colleges. A planned $2.2 billion deferral buy-down would be rescinded, and K-14 programmatic spending would be cut by over $3 billion, mostly to 'make room' for the shift of K-14 general obligation bond debt service and 'Early Start' (a developmental services program) into Proposition 98. Were this to happen, K-12 schools would be authorized to reduce their costs by shortening the 2012-13 and 2013-14 school years by another 15 days each (in addition to the five days per year already authorized),[1] and Community Colleges would likely reduce spring course offerings. In addition, billions of dollars in K-14 apportionment funding would be deferred until later in the fiscal year, thus requiring schools and community colleges to increase their borrowing for cash-flow purposes. ***Legislative Democrats rejected both an alternative plan offered by the Legislative Analyst that would have softened the blow to education and a Republican plan that would have protected education from these trigger cuts without raising taxes.***

Redevelopment agency (RDA) revenues. The final budget package offsets Proposition 98 General Fund costs by $133 million in 2011-12 and almost $1.7 billion in 2012-13, in recognition of additional property tax revenue that will flow to schools rather than RDAs resulting from the legislative Democrats'

[1] Contingent on the consent of their labor unions: absent that consent, many districts would likely become insolvent and would approach the state for emergency 'bailout' loans that could reach into the hundreds of millions of dollars or more.

decision to disband RDAs. In addition, over $1.4 billion in liquid assets from RDAs will be allocated to schools and community colleges in 2012-13, for one-time General Fund savings of the same amount.[2] *Additional information regarding redevelopment can be found on Page 45*.

Deferral buy-down. As noted above, the final budget anticipates an inter-year funding deferral buy-down of over $2.2 billion. Contingent on voter approval of the November 2012 tax hike, K-14 inter-year deferrals will drop from $10.4 billion to $8.2 billion.

K-12 growth and COLA. The final budget provides $169 million for anticipated 0.34 percent (.0034) enrollment growth in 2012-13. School district and county office of education 'deficit factors' will rise to over 22% each, in recognition of the budget's suspension of the statutory K-12 cost-of-living adjustment (which would otherwise be 3.24%) in 2012-13. Adopting these deficit factors in statute creates a symbolic liability in that it signals the Legislature's and Governor's intent to eventually restore revenue limit funding to 100 percent of what it would have been absent reductions and foregone COLAs.

Charter schools. The final budget includes a $53 million baseline augmentation to categorical block grant funding, to support expected growth in the number of charter school students, and makes a variety of statutory changes that should expand charters' access to credit.

Mandate reform. The final budget provides new K-14 education mandate incentive block grants totaling $200 million (about $167 million for K-12 and about $33 million for the Community Colleges), as an alternative to the traditional mandate claiming process, similar to the proposal in SB 887 authored by Senator Emmerson in 2011. The block grant would provide funding of $28 per student to K-14 agencies (except for charter schools, who would get $14 per student).[3] Schools and Community Colleges who opt to continue claiming through the traditional claims process may do so, but no funds are budgeted for those claims, so claimants will have to wait (possibly several years) for reimbursement.

Home to school transportation. In a move welcomed by both sides of the aisle, the final budget restores about $500 million in home to school transportation funding which had been proposed for elimination in January.

Military school facilities repairs. Senate Republicans proposed to appropriate funds sufficient to draw down about $166 million in federal funding to repair California public school facilities on or near certain military bases. Legislative Democrats rejected that appropriation and instead adopted weaker supplemental report language that only states Legislative intent to 1) request a waiver by August 1, 2012, to enable California to access federal funds, 2) request federal consideration of state and local facilities funding already spent on the schools targeted for repairs, and 3) expend any federal funding received at the same targeted school sites.

Categorical flexibility. The final budget package continues the local categorical funding flexibility currently in place, and funds most categorical programs at the same level in 2012-13 as in 2011-12.

Governor's weighted pupil formula rejected. The final budget rejects the Governor's proposal to permanently increase flexibility and local control by collapsing most categorical programs and existing revenue limit funding into a single funding stream known as a 'weighted pupil formula', and instead continues traditional revenue limit and categorical funding mechanisms.

Child care. The Governor proposed to fund child care programs traditionally administered through the California Department of Education (CDE) at $1.57 billion in 2012-13, and to begin shifting program administration away from CDE to the counties, overseen by the Department of Social Services. The

[2] The Legislative Analyst disputes these assumptions and believes that a much lower amount will flow to schools.
[3] Per the LAO, state law requires charter schools to complete only 17 of 36 active mandates.

Legislature's budget package rejected the administrative shift and increased General Fund support by $268 million, to about $1.84 billion. The Governor subsequently vetoed $20 million in non-Proposition 98 alternative payment (voucher) funding and about $30 million in Proposition 98 state preschool funding, thereby reducing General Fund support for child care (including state preschool) to about $1.79 billion.[4] Thus, even after his vetoes, the 2012-13 budget still provides almost $218 million more for child care than the Governor proposed to spend ($1.79 billion vs. his proposed $1.57 billion).

Transitional kindergarten. The final budget rejects the Governor's proposal to suspend implementation of the new transitional kindergarten (TK) program created pursuant to Chapter 705, Statutes of 2010 (Simitian). Most Republicans opposed that measure because 1) it implements a costly new universal preschool-type program at the same time existing educational programs are being squeezed, 2) research has shown that the positive effects of universal preschool on student achievement are short-lived, and 3) California voters have already rejected universal preschool at the ballot box. Regardless, under this budget package, implementation of the new TK program will proceed as planned.

Governor's vetoes. In addition to the $50 million veto of child care funding referenced above, the Governor used his blue pencil to make several other reductions to K-12 education funding. Most notably, he:

- Eliminated all funding ($15 million Proposition 98 General Fund) for the Early Mental Health Initiative (EMHI) program
- Eliminated all funding ($10.1 million non-98 General Fund) for meals served by non-public entities such as private schools and child care providers
- Eliminated all funding ($8.1 million in one-time Proposition 98 Reversion Account funds) for the Advancement Via Individual Determination (AVID) program

Community Colleges. The final budget package provides $5.82 billion in 2012-13 Proposition 98 funding for the CCCs, up from $5.25 billion in 2011-12. It makes several adjustments to CCC funding, most notably:

- Provides CCC mandate block grant funding of $33.3 million, to support annual reimbursements of $28 per full-time-equivalent student (see K-14 mandate reform section above).
- Contingent on voter approval of the Governor's tax hike, provides an inter-year funding deferral buy-down of $160 million, thus reducing CCC inter-year funding deferrals to about $800 million.
- Contingent on voter approval of the Governor's tax hike, provides apportionment growth funding of $50 million.
- Should the voters reject the Governor's tax hike, eliminates the deferral buy-down and apportionment growth funding referenced above, and triggers an automatic $338 million reduction in programmatic funding.
- Increases fees for students from neighboring states with whom California has reciprocal state attendance agreements to twice what California students pay in 2012-13, and three times what they pay in 2013-14 and beyond (California residents currently pay $46 per credit unit).

Under the final budget package, the Community Colleges continue to get their statutory share of Proposition 98 funding (roughly 11 percent). ***Fees rise in summer of 2012 to $46 per credit unit, but are still among the lowest in the nation, and students from families with incomes of up to about $80,000 (roughly 70 percent of CCC full-time-equivalent students) continue to receive fee waivers.***

[4] In addition, the federal government provides about $700 million annually for child care administered by CDE.

Local libraries. The education section of the state budget traditionally includes funding for state and local libraries. The Governor's budget proposal would have continued the elimination of funding for local libraries that was initially 'triggered' in December 2011. In an effort to meet federal 'maintenance of effort' and match requirements and thereby continue to draw down federal library funding, the final budget package restores $4.7 million in General Fund support for local libraries.

Missed opportunities. This budget package does *not* ask the voters to bring Proposition 49 before- and after-school programs back 'on-budget' so as to make that $550 million in Proposition 98 funding available for higher priority uses. ***Furthermore, it fails to repeal existing statutory restrictions on schools' authority to contract out for non-instructional services, which could free up several hundred million local dollars each year for higher priority uses, or to make other needed reforms relative to seniority-driven layoffs, substitute pay, layoff notice deadlines, or employee dismissal for cause.***

Higher Education (non-Proposition 98)

UC and CSU. The final budget package provides 2012-13 General Fund support for UC and CSU of about $2.4 billion and $2.0 billion[5], respectively. Student fee revenue would bring in another $3.4 billion and $2.4 billion, respectively. The budget holds UC and CSU harmless from any further reductions beyond those 'triggered' in 2011-12. Its most notable adjustments to the segments' budgets include:

- A $90 million increase to UC's base budget, to strengthen its retirement fund. This augmentation sets a precedent that could be the first step toward eventual General Fund support of several hundred million dollars annually.
- Augmentations of $125 million each in 2013-14 General Fund support, but only if voters approve the Governor's tax hike *and* the segments continue their 2011-12 student fee levels ($12,192 and $5,472, respectively) through 2012-13.[6]
- Rejection of the Governor's proposal to enable CSU to control costs through negotiations with active employees regarding health benefits, similar to the statutory authority currently provided to the Department of Personnel Administration for most other state employees. Currently CSU health benefit rates are set in statute at 100% coverage for employees and 90% for employee dependents.

Trigger cuts. Should voters reject the Governor's November tax hikes, General Fund support of the segments would be automatically reduced by $250 million each. ***Republicans proposed an alternative solution that would have eliminated the need for these trigger reductions, but legislative Democrats rejected that proposal and instead targeted students in an effort to persuade voters to support new taxes.***

Student financial aid. In 2011-12, the State of California spent over $1.5 billion on student financial aid. The Governor's budget proposals for 2012-13 would have reduced this spending by almost $300 million. However, legislative Democrats rejected all but $55 million of his proposed programmatic reductions, including his proposals to 1) conform maximum CalGrant award calculation methodology to federal Pell Grant methodology, 2) raise minimum grade point average (GPA) requirements for CalGrants, given the low rates of persistence and success by students with lower GPAs, and 3) reduce maximum CalGrant awards for students attending non-public colleges (although it did reduce these awards starting in 2013-14).

Using his blue pencil, the Governor forced another $22.6 million in General Fund savings through a veto that will impose five percent reductions to several 2012-13 CalGrant awards, including maximum awards for students attending non-public colleges, CalGrant B access awards, and CalGrant C tuition/fee and book/supply awards.

Aside from the $22.6 million veto, the final budget package makes a number of other adjustments to student aid funding, most notably:

- Augments General Fund support by about $27 million to allow students who initially were eligible for both CalGrant A and B, but were given a CalGrant B, to switch to a CalGrant A when renewing their awards.

---

[5] Plus $240 million for retiree health benefits which has in the past been funded directly by the state outside of CSU's budget.

[6] In November 2011, CSU Trustees voted to increase student fees beginning in fall 2012. To become eligible for the $125 million offered by this measure, they will have to rescind that fee increase, thereby losing $132 million in fee revenue, and if the voters reject the Governor's November tax hikes, they will have lost both the $132 million in fee revenue and this measure's $125 million conditional augmentation.

- Augments General Fund support by $31.2 million to cover the increased cost of CalGrant awards resulting from CSU's student fee increase from $5,472 to $5,970 effective fall 2012. (Note: CSU will become ineligible for the $125 million augmentation in 2013-14 referenced above if it does not rescind this fee increase).
- Uses about $800 million in federal TANF funds to support CalGrants, for one-time General Fund savings of the same amount. This is only a fund swap – it does not reduce programmatic spending for student financial aid.
- Uses $85 million in Student Loan Operating Fund to support CalGrants, for one-time General Fund savings of the same amount. This is another fund swap that does not reduce programmatic spending for student financial aid.
- Creates about $55 million in General Fund savings by reducing maximum allowable student loan default rates for institutions participating in the CalGrant program[7] to 15.5 percent, and restricts participation to institutions with graduation rates[8] of at least 30 percent (with some exceptions) for 2012-13 General Fund savings of $55 million.[9] ***These restrictions were intentionally written to avoid any effect on public institutions. It is unclear why public institutions should not be held to the same high standards as non-public ones.***

[7] Consistent with current law, these restrictions apply only to institutions where more than 40 percent of students take federal loans to attend college.
[8] As measured after 150 percent of the number of years normally required to attain the degree, e.g., six years for four-year programs and three years for two-year programs.
[9] CSU's systemwide six-year graduate rate is 55 percent, and UC's is 83 percent.

Health & Human Services

HEALTH

The budget package includes General Fund solutions totaling nearly $1.7 billion for health-related programs in 2012-13. However, the majority of these "solutions" are payment deferrals and fund shifts that do not result in programmatic spending reductions. Significant budget actions for each department are discussed below.

Department of Health Care Services (DHCS)

Savings Actions. The budget enacts General Fund solutions of $1.2 billion in 2012-13 for Medi-Cal. Over half of this amount results from cash deferral gimmicks totaling $648 million, while another $437 million represents payment reductions and fund shifts for hospitals and nursing homes. More specifically, key General Fund solution items are as follows:

- *Coordinated Care Initiative (CCI).* The 2012 Budget Act authorizes an amended version of the Governor's CCI proposal, which will deliver all health and long-term care and social support services through Medi-Cal managed care plans for "dual eligible" enrollees in eight counties. The budget action also authorizes a Medi-Cal cash payment deferral to shift a net $611 million in spending from 2012-13 to the following year. Unfortunately, the enacted CCI is unlikely to achieve real savings since it maintains significant flaws in current programs and shifts collective bargaining for In-Home Supportive Services (IHSS) to the state. In the absence of a convincing proposal to achieve real savings, the cash payment deferral is a gimmick of the sort that Governor Brown has derided. Also, shifting IHSS collective bargaining to the state will likely result in massive cost increases as it creates a salary "race to the top" fueled by legislative Democrats' giveaways to public employee unions.
- *Hospital Payment Shifts.* The budget breaks faith with an earlier agreement with hospitals by shifting funds previously designated for hospital payments to instead provide General Fund relief. The following actions provide a total of $293 million in savings:
  - *Supplemental Payment Reductions.* $150 million in savings by taking hospital fee revenues currently intended to make supplemental payments to private hospitals. The legislation authorizing the current fee program (SB 335, Hernandez, 2011), which hospital groups and Republicans supported as a means to draw down substantial federal funds, agreed to provide these supplemental payments to hospitals. The state already expects to realize $920 million in General Fund savings from the current fee program through December 31, 2013, but this action takes resources away from hospitals and uses the money to subsidize General Fund spending.
  - *Reductions to Large Public Hospitals.* $100 million in savings by requiring major public hospitals to share certain federal waiver funds with the state, rather than retaining the entire amount for themselves consistent with a fee waiver agreement. This proposal also requires that these hospitals work with the state to help achieve $400 million in state savings that are already included in the baseline budget but that might not be achieved.
  - *Stabilization Funding.* $43 million in one-time savings by shifting to the General Fund monies that are now set aside for supplemental payments to certain private and smaller public hospitals. The California Medical Assistance Commission typically allocated this money to hospitals that applied for the supplemental payments, but this action reduces reimbursement for those hospitals that would otherwise receive it.
- *Reimbursement Change for Small Public Hospitals.* $94 million in savings by shifting smaller public hospitals (such as district hospitals) to a new reimbursement methodology in which local public

authorities would certify their expenditures in order to receive federal matching funds. The proposal would also seek an increase in supplemental federal funds of $85 million to help offset losses for the small public hospitals. The DHCS estimates that the net effect on this group would be a reduction of $18 million in 2012-13 and an increase of $7 million in 2013-14. However, there is no assurance at this time that the federal government would approve more supplemental funding for these hospitals, and even it did, other budget actions to take back supplemental payments demonstrate that district hospitals may be unwise to rely on those funds. In addition, shifting over to the "certified public expenditure" methodology effectively provides hospitals a payment rate equal to about 50 percent of their costs. It is not clear how many affected hospitals are currently above or below that rate, so this budget action could be either an increase or decrease for individual hospitals. **In addition, this action drastically changes the reimbursement method for small and often rural hospitals with very little advance notice or time for those hospitals to evaluate the effects.**

- *Nursing Home Payments.* This budget also breaks another agreement with legislative Republicans and nursing home facilities. It authorizes $88 million in savings by freezing rates for nursing homes in 2012-13, instead of providing a promised 2.4 percent increase. The budget also includes a $37 million cash deferral gimmick for nursing homes. These nursing homes operate under the bipartisan AB 1629 fee waiver program, which has continued under a series of sunset extensions. The General Fund already realizes substantial savings from this fee program, which is currently scheduled to expire July 31, 2013.
- *Retroactive Costs for Managed Care Plans.* $48 million in one-time savings would result by removing the requirement for County-Operated Health Systems (COHS), one type of Medi-Cal managed care plan, to cover health care services for new Medi-Cal enrollees provided up to 90 days before their enrollment. The two other types of Medi-Cal managed care plans are currently not responsible for such costs. These retroactive costs for COHS would now be covered by Medi-Cal fee-for-service, which produces a short-term cash solution by delaying payment for the services into the next fiscal year.
- *Use of First 5 Funds.* $40 million in savings by seeking a voluntary shift of First 5 Commission (Proposition 10) funds to Medi-Cal children's services. This is an appropriate reprioritization of these funds, given the state's fiscal crisis and questionable past uses of First 5 funds by the state and county commissions. However, as Republicans noted in their alternative budget proposal, First 5 previously provided as much as $131 million in recent years for General Fund savings, compared to a total of $80 million in this budget (including this item and another $40 million in Developmental Services). This action justifiably could have been larger, although it moves in the right direction.
- *Preventable Hospital Admissions.* $30 million in savings by reducing Medi-Cal payments to hospitals for preventable medically acquired conditions, such as surgical infections. This change is required by federal regulations, although the budgeted savings may be significantly overstated.
- *Copayments.* Savings of $20 million in 2012-13 by requiring mandatory copayments for non-emergency use of hospital emergency departments ($7 million) and for some pharmacy services ($13 million). The emergency department copay would be $15 per non-emergency visit, and would apply only to managed care plan enrollees (since managed care plans are required to provide adequate access to other than hospitals, non-emergency care services). The pharmacy copayment generally would be $1 for a "preferred" drug, unless obtained through mail order, or $3.10 for drug that is not on Medi-Cal's preferred drug list. While Medi-Cal needs to obtain federal approval for a waiver to implement these copayments, this proposal appears more likely to obtain federal approval than the much broader copayment package approved in the 2011-12 budget, which the federal government rejected.
- *Laboratory Services Rate Change.* $7.7 million in savings by reducing Medi-Cal payments for laboratory services by 10 percent as a temporary measure until DHCS develops a new payment methodology that is comparable to other payers.

- *Managed Care in Rural Counties.* $2.7 million in savings by expanding Medi-Cal managed care to 28 rural counties where currently only fee-for-service Medi-Cal is available. The savings would increase to $9 million in 2013-14.
- *Managed Care Default Assignment.* $2.4 million in savings by altering the method of assigning new enrollees to Medi-Cal managed care plans to give higher priority to lower-cost health plans. This is a reasonable change to incorporate cost efficiency into the default health care plan assignment.

Federal Health Reform Costs. One feature of federal health reform is a mandated increase in Medicaid primary care payment rates to Medicare levels, beginning January 1, 2013. Although health reform proponents claimed that the federal government would fully fund this mandate, the budget includes General Fund costs of $77 million in 2012-13 to fulfill this requirement. The federal government will pay an additional $296 million to increase the rates. The state cost results from the federal provision that rates must be increased from the June 2010 level, which means the state must retract the provider payment reductions that it otherwise planned to implement for primary care services.

Department of Public Health (DPH)

Minor Savings. The budget package for DPH includes General Fund savings of $2.2 million General Fund in 2012-13 by eliminating the Public Health Laboratory Training Program, which provided grants to subsidize training as well as doctoral stipends and fellowships for individuals training for public health lab directorships.

Program Reorganization. The budget also reorganizes some health programs, including shifting (1) Every Woman Counts, (2) Prostate Cancer Treatment, and (3) the Family Planning, Access, Care, and Treatment Program to DHCS. The budget also establishes the Office of Health Equity within DPH, which combines several similar offices from other departments into one.

Proposition 63 Program Expansion. The budget authorizes expenditure of $15 million in 2012-13 from the Mental Health Services Act (Proposition 63) for a new Reducing Disparities Project, with the intent to spend $60 million over four years. While the motives behind this program may be commendable, the Administration missed an opportunity to seek voter approval for flexibility in using Prop 63 dollars to help the state budget deficit. Revenues from Prop 63 are now projected to increase to over $1.3 billion in 2012-13, a 45 percent increase compared with expectations in January 2011. A more prudent approach would be to reprioritize these *existing* tax revenues and spend this windfall in Prop 63 funds toward meeting the state's *current* budget needs, rather than starting new programs during a time of chronic deficits and reductions to many other worthy programs.

Managed Risk Medical Insurance Board (MRMIB)

Elimination of Healthy Families Program. The budget breaks faith with health care plans and Republicans by authorizing the elimination of the Healthy Families Program (HFP) over a 12-month period beginning in January 2013. The budget assumes $13 million in General Fund savings in 2012-13 from this action, with ongoing savings of $73 million. However, this savings amount is likely overstated because the eligibility administration costs for HFP children will be much higher than this budget assumes, once county welfare staff begin handling enrollment administration instead of HFP's contracted vendor. New Medi-Cal costs for county administration could reach $213 million total funds ($75 million General Fund) if costs increase from the HFP level to the current Medi-Cal average. The 880,000 children enrolled in HFP also will find themselves less healthy with reduced access to health care providers once they shift to Medi-Cal, due in part to the significantly lower reimbursement rates paid by Medi-Cal. The Legislative Analyst's Office cited a survey indicating that **only 26 percent of pediatricians who now see HFP children but not Medi-Cal children would be willing to enroll in Medi-Cal to keep seeing their HFP patients.** Of pediatricians that now see kids in both programs, only 51 percent said they would continue treating HFP kids after they switch to Medi-Cal. The budget package includes some attempts to assess provider access before shifting the HFP children, but there is no substitute for simply leaving these kids in HFP, a program with a proven track record.

Managed Care Tax. The Administration continues to assume that the Medi-Cal managed care tax will be extended, but the budget itself does not authorize an extension. Legislative Democrats have indicated their intent to pursue an extension of the tax through policy legislation in August 2012, but Republicans should not support any extension unless the HFP elimination is reversed. This tax, originally enacted in 2009, has always been intended to maintain HFP as a partnership of publicly funded health coverage delivered through managed care plans. Republicans and managed care plans only agreed to support the tax, both initially and through two previous extensions, based on the understanding that it would support HFP as an intact program. The partisan budget signed by the Governor breaks faith by shifting all kids from HFP into Medi-Cal.

Department of Developmental Services (DDS)

Savings Actions. The budget includes General Fund savings of $240 million in 2012-13 for DDS programs, made up of the following significant actions:

- *Autism Services Shift to Private Insurance.* Savings of $69 million by assuming that autism-related services now provided by DDS will shift to private insurance following the implementation of SB 946 (Steinberg, 2011). That bill, which mandates that private insurers and health plans cover behavioral treatment services for autism and pervasive developmental disorder, takes effect July 1, 2012.
- *Autism Services Shift to Other Departments.* Similar to the shift to private insurers and health plans, the DDS budget assumes $10 million in savings due to a presumed shift of its services to CalPERS-provided coverage and the Healthy Families Program. However, neither of those programs' budgets recognized an increase in costs for such a shift, which calls the overall savings for this item into question.
- *Federal Funding Increase.* Savings of $61 million by shifting General Fund costs to federal funds received through an expected increase in the number of individuals served under the federal Home and Community-Based Services waiver.
- *Proposition 10 (First 5) Funds.* A voluntary shift totaling $40 million in First 5 funds to the state. As noted above for a similar action in the DHCS section, this is an appropriate reprioritization of First 5 funds.
- *Continued Rate Reductions.* $31 million in savings by extending a 1.25 percent reduction in payments to regional centers and community developmental service providers. This reduction replaces a 4.25 percent reduction that expired June 30, 2012, so most providers actually will realize a net increase in payment rates.
- *Deflected Admissions to Developmental Centers.* The budget assumes $20 million in savings from a series of policy changes designed to better serve particularly challenging cases in the community instead of in a developmental center (DC). New policies will include a moratorium on new admissions to DCs (with some exemptions), operation of a short-term crisis program at Fairview DC, restrictions on admissions resulting from criminal convictions, and expanding transition services at Porterville DC's Secure Treatment Program. **Unfortunately, the new policies also include statewide expansion of the so-called SB 962 homes, which are an unnecessarily expensive community treatment option.**
- *Supported Living Assessments.* Savings of $4.2 million by eliminating independent needs assessments and instead using broader standardized assessment questionnaires during the Individual Program Plan process.

Trigger Reduction. In addition to the mandatory savings actions, the budget package authorizes an additional $50 million in savings in the event that voters reject the Governor's tax increase initiative on the November 2012 ballot. No other health program has been targeted with a trigger reduction. As with the 2011-12 DDS budget trigger for $100 million, which was enacted after the state's revenues fell predictably short of the partisan budget's assumptions, the budget would require DDS to develop the specific means to achieve the $50 million target in consultation with stakeholders. Because this process would apparently not start before December, and given the lead time needed to implement many possible savings actions, it is possible that these trigger savings would not be achieved in 2012-13, even if the trigger is pulled.

Department of State Hospitals (DSH, formerly the Department of Mental Health)

Department Elimination and Creation. The budget package converts the old Department of Mental Health into the new DSH, which will focus solely on administering the state's mental hospitals. This reorganization is necessary following the realignment of community-based, non-institutional mental health programs to county administration. Following this realignment, the department's remaining responsibilities will consist almost entirely of managing the state mental hospitals. The budget also shifts other remaining community mental health responsibilities, such as oversight of Prop 63 programs and certain licensing functions, to other state departments.

Minor Savings. State savings of $3 million General Fund by expanding a pilot program to treat offenders deemed Incompetent to Stand Trial in county jails rather than state mental hospitals. The pilot program demonstrated that treatment in county jails restored offenders to competency more quickly, enabling them to go to trial faster. The budget package also helps prevent the possible erosion of $20 million in savings for 2012-13 associated with counties paying the full cost of housing certain inmates in state mental hospitals. The budget would allow the state to collect full rates from counties that do not contract with the state.

Caregiver Resource Centers. The budget maintains $2.9 million General Fund for grants to Caregiver Resource Centers, which provide assistance, counseling, and other support to individuals who care for family members suffering from a traumatic brain injury or other cognitive impairment. The Governor initially proposed to eliminate this funding, which helps support 11 centers around the state, but the Legislature rejected that proposal.

HUMAN SERVICES

The 2012 Budget includes total General Fund spending reductions of only $536 million within the state's human services programs, which is $800 million less savings than the Governor proposed in his January CalWORKs and In-Home Supportive Service (IHSS) proposals. The IHSS reduction in hours is only for 2012-13, and the CalWORKs savings will be achieved through a reduction to county administration rather than reduced grants or eligibility. The Governor had proposed to reduce grants, as well as restructure the CalWORKs program more restrictively, but the Legislative Democrats rejected his proposals. As a result, the budget only achieves 42 percent of the Governor's proposed savings for CalWORKs reform (2012 budget savings of $469.1 million compared to $1.1 billion in January).

CalWORKs

CalWORKs Reform Unlikely to Stick. The 2012 Budget revises to 24 (from 48 currently) the number of months a CalWORKs adult can remain on aid if they are not meeting federal work activity requirements. The Governor's "big win" on welfare reform are changes that won't really be felt for two years, and certainly aren't projected to save any money until 2015, if at all. The savings are not the point anyway. It will really just be about ensuring he can say he cracked down on welfare recipients.

Furthermore, the stricter time limit is not necessarily permanent as it would only take another majority-vote bill to undo the changes. Given the three year delay, Legislative Democrats could always go back on their word, undoing the Governor's "big win" on welfare reform and maintaining the welfare "status quo." The savings actually come from a reduction to county administration funding, reducing expenditures by not providing child care, transportation, and job training to parents of young children, allowing those parents to receive cash aid without moving any closer to work.

Moves Cost of Illegal Immigrants, Ineligible Adults, and Felon Cases to General Fund – The Governor's January proposal would have reduced the cost of the ever-growing population of welfare cases without an aided adult (commonly referred to as safety net, child-only or sanctioned cases) through a grant reduction. The 2012 Budget simply "re-brands" the program that includes cases with an illegal immigrant, fleeing felon, adult who has been on aid for five years, or has an adult in sanction status, including these types of cases as part of the Child Well-Being program and would now require a well-child exam, but without a threat of removal from CalWORKs if they fail to comply with the well-child "requirement." This caseload has become larger than the caseload that includes an aided adult subject to work requirements. Of the 586,432 cases projected for 2011-12, 300,999 are cases without an eligible adult. **Essentially, 51.3 percent of welfare cases involve no one in the family meeting work requirements.**

In addition, the budget shifts funding for the child well-being caseload from maintenance of effort (MOE) funding for TANF to General Fund, resulting in additional costs of about $300 million more than what the state is required to spend within the CalWORKs program. The Administration indicates this shift will provide some improvement to the state's work participation rate, but it is unknown exactly how much the participation rates will increase or how much the state will receive in federal penalty relief as a result of over-spending the state's MOE. What is clear is the fact that the state is spending more than is required on the CalWORKs program, a precedent that could have major General Fund implications in subsequent years if the state continues to spend more scarce General Fund resources than is needed to maintain federal TANF funds.
New Programs and Restorations. The 2012 Budget includes a number of restorations and a new program, as follows:

- **Work Incentive Nutritional Supplement.** The 2012 Budget delays implementation of this new state-only General Fund program until January, 1, 2014 which provides a food stamp benefit of $10 per month.

- **CalLearn.** The 2012 Budget restores the recently eliminated Cal-Learn program within CalWORKs. Funding for these case management services for pregnant welfare teens was suspended in the 2011 Budget, but like all Legislative Democrat reductions, it is now being reinstated, with full implementation by April 1, 2013 at a cost to the state of $35 million General Fund.

- **CalWORKs Earned Income Disregard.** The earned income disregard for CalWORKs recipients would now be an amount equal to the first $225 plus 50% of all additional income, effective October 1, 2013, increasing state costs by approximately $50 million upon full implementation. The 2011 Budget had included a reduction to the state's earned income disregard (savings of $80 million projected for 2011-12), but **like most reductions agreed to at one time by the Legislative Democrats, this too has been undone**, increasing costs within CalWORKs as a result of the more generous earned income disregard.

<u>In-Home Supportive Services</u>

The 2012 Budget projects the average monthly caseload in IHSS will be 452,438 recipients in 2012-13, **an increase 2.7 percent** above revised 2011-12 projections. In 2011-12, the average monthly caseload is projected to be 440,223, an increase of 1.7 percent from the prior year. The Governor had proposed policy changes in January that would have saved $225 million General Fund, but the final budget only includes one-time savings of $52.2 million General Fund in 2012-13, a loss of $173 million in General Fund savings.

Continues 3.6 Percent Reduction in Hours for One Year. The budget includes savings of $52.2 million General Fund as a result of reducing IHSS hours by 3.6 percent for 2012-13 only. This reduction will not make a dent in the steadfast growth of the IHSS program ($52.2 million in General Fund reductions out of a total of $1.5 billion General Fund for the program).

Last Year's Phony Savings. The 2012 Budget includes $101.9 million General Fund in 2011-12 and $212.8 million General Fund in 2012-13 as a result of phony savings assumptions included in the 2011 Budget. The proposal to require that recipients receive certification by a licensed health care professional prior to enrolling in or remaining on the program did not achieve the level of savings assumed in the budget (an erosion of $44.6 million in 2011-12 and $117.2 million in 2012-13) because the universe of authorized providers became so extensive that now recipients could have their psychiatrist, optometrist or massage therapist sign the certification verifying the need for in home support services. Additionally, the budget no longer assumes implementation of the IHSS provider tax. The Administration indicates that the federal government has not officially made a decision, and believes it is no longer prudent to continue to assume savings. This will increase General Fund by $57.3 million in 2011-12 and $95.4 million in 2012-13.

Bogus Federal Funds Backfill. The budget continues to assume a December 1, 2011 implementation of the Community First Choice Option for the IHSS program pending federal approval, and includes $113.6 million General Fund savings in 2011-12, and $178 million General Fund savings in 2012-13 as a result of the increased federal financial participation rate. It seems unlikely these savings will materialize as the federal government has not given the state any time frame for approving or disapproving the state's proposal, and as such, including savings in the budget will likely lead to a General Fund deficiency in 2012-13.

Integration of IHSS into Medi-Cal Managed Care. The 2012 Budget includes statutory changes necessary to implement the Coordinated Care Initiative (CCI). For additional information on the overall concept of the CCI, *please see the Health section beginning on page 21*. The proposal results in the following changes within the state's IHSS program:

- **Shifts IHSS Collective Bargaining Responsibilities to the State.** This policy change is the most troubling. Creating a statewide collective bargaining process in eight counties for IHSS providers will increase the cost of providing services because it will create a race to the top of the current county pay scales and Legislative Democrats have shown a deep political desire to augment public employee union pay. While Medi-Cal managed care plans would be providing services via a capitated rate per recipient, escalating provider wages will eventually lead to inequity between the rate paid and the cost of providing services, likely a cost shift to manage care plans for higher IHSS salaries in the near future.

- **Maintains County Share of Cost.** The initiative would provide for maintenance of effort funding from counties in the IHSS program to be held flat at the level expended for 2011 and holds counties harmless for any additional costs that may result from increased wages and compensation in subsequent years. Obviously the counties can see the writing on the wall and don't want to be held accountable when wages increase as a result of state-level collective bargaining.

- **Integration of Long-Term Care Services.** The initiative limits integration of these services, including IHSS and nursing homes, to only the Dual Demonstration Pilot counties (eight counties beginning in March 2013). No further expansion can occur without authorization from the Legislature.

- **Continues County Role as Program Administrator**. The initiative continues to permit counties to administer the IHSS Program, including assessments and determining hours for recipients. Health plans may authorize additional **(but not reduced)** home and community-based services, including in-home service hours. IHSS consumers also retain the authority to hire, fire, and direct their care providers, and will be able to decide whether they want to participate in care coordination teams. Keeping the administrative structure of the program the same will inhibit changes that are likely needed to increase program integrity and reduce overall costs. Without flexibility, managed care plans will not be able to properly manage the level of services necessary to maintain fiscal integrity within IHSS.

The Governor's once-promising CCI concept from January has unraveled in part due to a giveaway to unions. The program will move collective bargaining for IHSS workers from the current county-by-county arrangement to statewide bargaining, which will give unions substantially greater ability to drive costs higher. At the same time, health care plans would not be allowed to reduce IHSS hours even if it is apparent that those hours are not needed at the levels claimed. The rapid rise of IHSS costs in the past decade has been a significant factor in the state's chronic budget problems, and this new giveaway to unions will mitigate any gains that might otherwise have been achieved through this initiative.

Child Welfare Services-Realignment

The 2012 Budget includes a permanent funding source for programs realigned to the counties in 2011 (including child welfare services and foster care). The funding includes an increase to what is considered the “base” funding by $53.9 million for foster care and child welfare programs (on top of the $200 million “promised” for child welfare services base restoration) in 2012-13, 2013-14, and 2014-15. The increase reflects the Administration’s intent to fully fund implementation of AB 12 (Beall), Chapter 559, Statutes of 2010, which expanded foster care benefits eligibility up to age 21, and which Republicans generally supported. Natural growth in the base funding for foster care, child welfare services, and adult protective services increased $5.5 million in 2012-13.

Realignment Clean-Up for Child Welfare and Foster Care. The 2011 Budget realigned $1.6 billion in state funding for the child welfare services (CWS), foster care, and adoptions programs to the counties. For that first year, no changes were made to state law governing those programs. Among other provisions, the 2012 Budget includes changes that will increase the cost of the Transitional Housing Placement Program as well as expanded foster care. Additionally, the budget includes the following programmatic changes:

- **Flexibility for Counties.** Creates more flexibility within the requirements of specified programs such as adult protection services and Kinship Support services, which already offered some degree of county option, increasing the counties ability to determine local need.

- **Accountability and Oversight Provisions**. Requires specified reporting related to 2011 realignment of CWS programs, including an annual report that summarizes outcome and expenditure data for counties. Additionally, the budget requires the department and counties to develop agreed upon performance targets for improvements. These provisions will provide the Legislature with information about the realigned programs, how counties may or may not be maintaining funding and how children that come into contact with the child welfare programs may be faring in the post-realignment CWS world.

- **Transitional Housing Placement**. Increases transitional housing services for 18 through 20 year olds exiting the foster care system by expanding eligibility for extended foster care and provides extended foster care up to age 21, effective January 1, 2014. The budget also revises licensing or certification standards for transitional housing and increases basic care and supervision rates paid to foster families certified by foster family agencies. **Both of these changes will increase the cost of the program** for counties, resulting in challenges at the local level to maintain funding for non-entitlement programs at pre-realignment levels.

Department of Child Support Services

The 2012 Budget reduces funding for Local Child Support Agencies by $14.7 million ($5 million General Fund) for 2012-13 only and continues to suspend the county share of collections for an additional year, resulting in savings of $31.9 million General Fund in 2012-13.

Department of Alcohol and Drug Programs

The 2012 Budget transfers the administrative and programmatic functions of DADP to other departments within the Health and Human Services Agency (HHSA), effective July 1, 2013. The budget requires HHSA, in consultation with stakeholders and affected departments, to prepare a detailed plan for the reorganization of DADP's functions, to be submitted to the Legislature as part of the 2013-14 Governor's Budget. Unfortunately, the state budget reflects no savings from this consolidation, thus bringing into question the need to implement it.

Realignment

The budget reflects the continued implementation of the dangerous and irresponsible 2011 Public Safety Realignment, which began with the enactment of AB 109, and establishes a permanent funding structure for the various affected local entities. The Governor and legislative Democrats claim realignment will save money, but total realignment spending is projected to be $5.9 billion in 2012-13, growing to $6.8 billion by 2014-15. (*See funding table on next page.)*

Continues to Favor Social Programs Over Public Safety. Relative to the Governor's January proposal, the enacted budget adjusts realignment spending by marginally increasing funding for Early and Periodic Screening, Diagnosis and Treatment (EPSDT), Mental Health Managed Care, substance abuse treatment, foster care and child welfare services, and adult protective services, and by decreasing funding for juvenile justice and community mental health programs. It **allocates 65 percent of future revenue growth to the non-law enforcement (social) programs** that have been realigned, and only 35 percent to law enforcement. It establishes the 2011-12 funding level for mental health programs realigned in 2011 as a funding floor. In addition, the budget requires annual county allocations for child welfare and adult protective services programs to be no less than each county's prior year allocation – a protection not afforded to realigned public safety programs. **Overall, these adjustments reflect the majority party's continued prioritization of social welfare services over traditional public safety programs.**

Fails to Provide Details on Local Funding Allocations. The budget does not provide details on the methodology for determining county-by-county annual funding allocations for many programs. Instead, it delegates this process to the Department of Finance in collaboration with other state agencies and the California State Association of Counties. **The budget is a failed attempt to lock in a permanent realignment funding structure and will leave counties vulnerable to a bureaucratic process.**

Ignores Public Safety Threat. Other than authorizing $500 million in new lease-revenue bond (LRB) funding for counties to build facilities to manage realigned offender populations, the budget does little to address the multitude of issues and mounting criticism that the Governor's realignment plan jeopardizes public safety. In fact, it compounds the problem by adding new crimes to the list of jail felonies created by AB 109 and extinguishing $4.1 billion of lease-revenue bond funding that should be used for increased state prison or local jail capacity. Local law enforcement officials describe with increasing frequency the lack of resources and manpower to protect their communities. News stories abound of AB 109 offenders, now under local supervision, committing serious and violent crimes. **Realignment poses an ongoing threat to public safety. The majority-vote budget reflects the Administration's and legislative Democrats' continuing fantasy that the difficulties imposed on local law enforcement agencies and the threat to public safety are not serious.**

Costs Continue to Grow. As mentioned above, the budget includes $500 million in LRB funding for counties to construct facilities to manage realigned offender populations. It also includes General Fund increases of $750,000 for the Board of State and Community Corrections to provide support to local agencies to implement realignment and $20 million for a grant program to help mitigate the impact of realignment on city police departments. The $20 million is included in the trigger cuts that will take effect if the Governor's tax increase initiative fails at the ballot box in November. Other new realignment spending includes $8.9 million for support for local agencies implementing realignment, $2 million for CDCR to implement realignment-related layoffs, and $2.8 million to replace trial court funding that was "inadvertently transferred to the counties" as part of realignment. The budget reflects total cost growth for realignment of more than $365 million from 2011-12 to 2012-13, reaching $1.3 billion by 2014-15. **It appears realignment will cost the state money rather than saving the state money.**

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
Local Public Safety Programs	489.9	489.9	489.9	489.9
Local Jurisdiction of Lower-level Offenders and Parole Violators				
Local Costs	239.9	581.1	759.8	762.2
Reimbursement of State Costs	888.9	-	-	-
Realign Adult Parole				
Local Costs	127.1	276.4	257.0	187.7
Reimbursement of State Costs	262.6	-	-	-
Mental Health Services				
EPSDT	-	544.2	544.2	544.2
Mental Health Managed Care	-	188.7	188.7	188.7
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	1,565.4	1,605.6	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	486.6	1,014.7
Total	$5,592.3	$5,889.8	$6,303.6	$6,710.9
Vehicle License Fee Funds	$439.4	$455.1	$462.3	$471.1
1.0625% Sales Tax	$5,152.9	$5,434.7	$5,841.3	$6,239.8
Total Revenues	$5,592.3	$5,889.8	$6,303.6	$6,710.9

Source: Department of Finance

Public Safety & Judiciary

Department of Corrections and Rehabilitation

The budget increases General Fund spending for the Department of Corrections and Rehabilitation (CDCR) to $8.9 billion compared to the Governor's January proposed spending level of $8.7 billion. The increase is primarily attributable to a $128.4 million augmentation to the Receiver's budget (*see 'Restoration of Funding for the Receiver' on page 35*).

Population Changes. Institutional and parole average daily populations (ADP) are projected to decrease significantly for both adult and juvenile populations, primarily due to the impact of realignment. However, 2012-13 adult parole ADP increases significantly relative to Governor's Budget projections. This is due to a number of factors, including a technical change in the way CDCR counts certain offenders who complete parole revocation terms and are released to county supervision, and a one-month delay in implementing postrelease community supervision for offenders completion revocation terms. Also, the rate of parole revocation has not decreased due to realignment as the Administration projected, which results in a longer average length-of-stay on parole than was projected in January.

Projected institutional and parole populations are as follows:

- *Adult Institutions.* Institutional ADP is projected to decrease from 148,669 in 2011-12 to 129,961 in 2012-13 (decrease of 18,708 inmates).
- *Adult Parole.* Parole ADP is projected to decrease 103,034 in 2011-12 to 65,694 in 2012-13 (decrease of 37,340 parolees).
- *Juvenile Institutions.* ADP is projected to decrease from 1,090 in 2011-12 to 992 in 2012-13 (decrease of 98 wards).
- *Juvenile Parole.* ADP is projected to decrease from 700 in 2011-12 to 450 in 2012-13 (decrease of 250 parolees).

Elimination of Funds for New State Prison Capacity. The budget extinguishes roughly $4.1 billion of Lease-Revenue Bond (LRB) authority that was authorized by AB 900 to expand prison capacity through the construction of up to 40,000 new beds. Despite bipartisan support for AB 900, it seems legislative Democrats never intended to allow any significant number of new beds to be built. Initially, the Attorney General's office refused to issue its customary "clean bond opinion," which is needed for the state to sell a bond issue. After several years of machinations, the clean bond opinion was finally issued, at which point legislative Democrats took over via the Joint Legislative Budget Committee (JLBC). The JLBC rejected or delayed project after project, effectively killing projects that would have provided nearly 8,000 additional prison beds. **This budget essentially puts the final nail in the coffin of prison capacity expansion under AB 900.** In addition to eliminating much of the remaining AB 900 LRB authority, the budget also assumes a $15 million reduction in 2012-13 spending from the $300 million AB 900 General Fund appropriation for infrastructure improvements.

Corrections Blueprint. Three weeks prior to the May Revision, the Administration released a blueprint-like document entitled *"The Future of California Corrections."* The document lays out the Governor's plan to reform CDCR to "save billions of dollars, end federal court oversight and improve the prison system." The blueprint is intended to be the framework under which CDCR achieves the $1.2 billion in 2011 Realignment General Fund savings for 2012-13 assumed in the Governor's Budget. The budget reflects the following policy changes, as embodied in the blueprint document:

- *Revision of the Inmate Classification System.* CDCR will make arbitrary adjustments to the point system used for inmate security classification. It will increase the number of points required for an inmate to be classified as Level II or Level III in an effort to align the security characteristics of the population with the available number of beds in each security level. The policy begs the question whether there is any point at all to having a security classification system, if we can simply move the cutoff points with no impact on the safety of the public or the correctional officers and staff at the institutions. Rather than letting the proven classification system determine the security risk of the inmate and thus, where he or she should be housed, this policy suggests that the type of housing available can determine the security risk of the inmate. This puts correctional officers at risk.

- *Return Out-of-State Inmates.* California currently houses approximately 9,500 inmates in out-of-state facilities operated by private correctional companies. The use of these private facilities has been necessary to relieve prison overcrowding, since legislative Democrats have essentially refused to build new state prison beds. In the face of the federal court's recent population reduction order, which requires California to bring the population of inmates housed within the state's 33 institutions to within 137.5 percent of design capacity by June 2013, the Governor proposes to bring 9,500 more inmates into those institutions. Unless the Governor and legislative Democrats are ready to join Republicans in building prisons to replace aging facilities and accommodate future population growth, these out-of-state contracts could end up being the only remaining alternative to early release. Furthermore, because they are not housed in facilities operated by CDCR, the inmates in the out-of-state facilities are not currently counted as part of the population included in the reduction order. **The Governor's plan, if implemented, will subject them to the reduction order, creating pressure to release inmates early or relax sentencing laws.** Adding to this pressure, the facilities plan contained in the blueprint will actually result in a net reduction of about 2,000 beds.

- *Expanded Rehabilitative Programming.* The blueprint includes system-wide enhancements to academic and career technical education programs and substance abuse treatment, and introduces cognitive behavioral therapies to address criminogenic needs, including anger management, family relationships, and criminal thinking. Reentry hubs will be established to concentrate programmatic resources on offenders who are about to return to their communities. These types of activities have proven effective in other states at reducing recidivism and the cost of corrections. However, early efforts in California have resulted in high costs and abject failure. The success of the blueprint will hinge on CDCR's ability to change its internal culture, to correctly identify criminogenic needs, and deploy effective programming. History suggests this will be a monumental challenge.

- *Standardized Staffing Levels.* Part of the blueprint involves getting rid of the outmoded staffing ratios that have historically been used to provide resources for the Department. CDCR is undergoing a system-wide review of custodial staffing levels. The blueprint will essentially zero-base staffing levels for each institution and standardize future staffing requirements based on the type of facility to be activated or deactivated, rather than projected changes in ADP.

- *Compliance with Court-Imposed Health Care Requirements.* The blueprint proposes several steps intended to free the state from federal court oversight of its prison dental, mental health, and medical programs. These steps include providing resources necessary to administer mental health treatment in a timely manner, improving facilities to provide adequate treatment space, implementing a medical classification system that ensures inmates are housed in facilities appropriate to their individual health care needs, and modifying various systems to account for the reduced population, post-realignment. Also included is statutory authorization to use existing LRB authority, authorized by the Public Safety and Offender Rehabilitation Services Act of 2007 (AB 900), to move forward with a previously-approved project to convert the DeWitt Nelson Youth Correctional Facility in Stockton to a 1,133-bed adult facility and annex it to the new California Health Care Facility to provide health care services to prison inmates. Finally, the budget includes $810 million in new LRB authority to build up to three 800-bed dormitory-style facilities (up to 2,400 total beds) on existing prison campuses to support the delivery of prison medical services.

- *Compliance with Court-Ordered Population Reduction.* Part of the Administration's plan to get out from under federal court oversight is to petition the court to relax the requirements of its population reduction order, allowing the state to operate its prison system at 145 percent of design capacity, instead of 137.5 percent. The plaintiffs in the *Plata* case have already filed a motion requesting the court to order CDCR to submit a revised population reduction plan that meets the original requirement of 137.5 percent by June 2013. When viewed in the context of the above plan to bring the 9,500 out-of-state inmates back to California prisons, **it appears the Governor and legislative Democrats have set the stage for Realignment 2.0, where the federal courts once again order the state to reduce its prison population and the Governor is "forced" to comply.** If this were the case, it would give the majority party political cover to implement additional policy changes that further erode public safety.

Elimination of Civil Addicts Program. Effective July 1, 2012, the budget prohibits any new civil commitments to state prison for addiction to narcotics. No savings are associated with this policy change, although it will put unrehabilitated drug addicts back into our communities where many of them will commit more crimes and create new victims.

Alternative Custody for Serious and Violent Felons. The budget jeopardizes public safety by expanding the existing female offender alternative custody program to include women with prior convictions for serious or violent felonies. The most ardent supporters of evidence-based rehabilitative programs recognize that those programs are most likely to result in positive outcomes when applied to low-risk populations. The populations to which this budget expands program eligibility are moderate- to high-risk. As with the elimination of the civil addicts program, this policy change has no associated savings.

Expansion of Integrated Services for Mentally Ill Parolees. Despite having no associated savings, legislative Democrats added language to the budget requiring CDCR to expand its existing Integrated Services for Mentally Ill Parolee-clients (ISMIP) program to provide a full spectrum of community services and a continuum of care for offenders with mental health needs. The budget requires CDCR to focus on providing housing, collaborate with parole outpatient clinics, and ensure that providers work with county and regional services to bridge services for parolees as they transition off parole. **There is no budget augmentation included for this program expansion, but the new ISMIP requirements will almost certainly lead to General Fund cost pressure in future years.**

Consolidation of Juvenile and Adult Parole. The budget includes a technical adjustment to reflect the consolidation of the Division of Juvenile Parole Operations (DJPO) within the Division of Adult Parole Operations. The consolidation has allowed CDCR to achieve administrative efficiencies, including closing DJPO facilities and eliminating duplicative support and administrative services. The consolidation is consistent with the 2010 shift of offenders released from the Division of Juvenile Justice (DJJ) to the jurisdiction of local probation departments instead of state parole, pursuant to Chapter 729, Statutes of 2010 (AB 1628). As the population of juvenile offenders still on state parole dwindled, it became increasingly expensive to maintain separate operations for juvenile parole. Effective October 2011, CDCR consolidated the two divisions.

Early Release and Other Measures. The budget abandons the Governor's January proposal to realign all juvenile offenders to the counties. Instead, the Governor proposed (and the Legislature approved) four measures to generate $4.8 million in General Fund savings within DJJ. These proposals include a reduction in DJJ administrative staffing, an acceleration of the termination of state juvenile parole operations, a reduction in DJJ's age of jurisdiction from 25 to 23 for all new commitments, and implementation of a $24,000 per ward fee charged to the county for each ward housed in a DJJ facility. In addition, legislative Democrats voted to prohibit DJJ staff from postponing a ward's parole consideration hearing date as a disciplinary measure (sometimes referred to as a 'time add'). While there are no savings budgeted in association with this policy change, the Legislative Analyst's Office suggests that some savings are likely to occur due to reduced custody time for some wards. **It should be noted, however, that if the loss of this disciplinary tool results in increased ward violence and/or decreased participation in educational or rehabilitative programming, any custody savings could easily be eroded by increased medical costs and/or recidivism.**

The population of juvenile offenders that still remains with the state represents the "worst of the worst," as all of the lower-level offenders have already been realigned to the counties. Counties have repeatedly asserted that they lack the resources, expertise, and facilities to deal with these offenders. Given these conditions, the enacted budget is an improvement over the Governor's January proposal to completely divest the state of its custodial role in managing juvenile offenders. **However, three of the DJJ policy changes included in the budget are problematic.** Reducing the DJJ's age of jurisdiction from 25 to 23 will shorten the time that some wards have to complete educational and rehabilitative programming. In fact, DJJ staff have testified in the past that they frequently lack adequate time with their wards to provide effective programming, even with the 25-year age of jurisdiction. This measure, coupled with the termination of state parole for all juvenile offenders 18 months earlier than originally contemplated by AB 1628 and the elimination of time adds as a disciplinary tool, will jeopardize public safety by returning many juvenile offenders to their communities before they are rehabilitated.

Sale of Southern Youth Correctional Facility. The budget includes trailer bill language declaring the Southern Youth Correctional Reception Center and Clinic surplus property and authorizing the Department of General Services to sell the property to the County of Los Angeles at fair market value. This language allows the sale to occur sooner than it could following the normal state surplus property process. Proceeds will be used to pay off economic recovery bonds. Given the shrinking DJJ population, the fact that the facility was scheduled to be closed in January 2012, and the dire fiscal situation facing the state, the planned sale makes sense. Republicans have been advocating for years to allow the sale of unused and underutilized state properties.

Partial Restoration of Funding for the Receiver. The Budget Act of 2010 included an unallocated reduction of $820 million General Fund to the Receiver's baseline budget. The Budget Act of 2011 restored $726 million of that funding, but reduced the Receiver's other budget proposals by a total of $163 million. The Budget Act of 2012 includes an augmentation of $124.5 million General Fund to align the Receiver's budget with projected expenditures, restoring about half of the remaining reductions from the past two years.

Implementing the Receiver's Facility Plan. The budget includes $3.9 million General Fund, to provide staffing for the DeWitt facility ($1.6 million, 11.7 positions) and the Folsom Women's Facility ($2.3 million, 18.9 positions). Activation of both of these facilities is integral to both CDCR's blueprint plan and the Receiver's facility plan.

Board of State and Community Corrections

Chapter 36, Statutes of 2011 (SB 92) created the Board of State and Community Corrections (BSCC) as an independent government entity, eliminated the Corrections Standards Authority (CSA) from

CDCR, and shifted the CSA's duties to the newly created BSCC. The functions of the Office of Gang and Youth Violence Policy, which was formerly part of the California Emergency Management Agency (Cal EMA) and the California Council on Criminal Justice (formerly an independent council funded by grants passed through Cal EMA) were also consolidated within the BSCC. The Governor's January budget proposed total BSCC funding of $16.9 million General Fund and $92.2 million in other, mostly federal funds, the majority of which was shifted from CDCR and Cal EMA.

City Police Grants. The enacted budget includes a $20 million General Fund augmentation for the BSCC for a grant program for city police departments. The program would help to mitigate the negative impacts of realignment. So much for realignment saving money, but at least the Governor and legislative Democrats are starting to acknowledge the public safety problems they caused.

Local Jail Construction Funding. The enacted budget also includes $500 million in new LRB authority for the acquisition, design, and construction of local facilities to help counties manage their offender populations. As the Governor and legislative Democrats were ramming realignment down the throats of Californians in 2011, Senate Republicans were warning that local jails would be inadequate to handle the population explosion and longer-term jail sentences that realignment would bring. Fast-forward one year, and state is incurring half a billion dollars more of debt to help local sheriffs deal with the realignment mess. So much for paying down the wall of debt. So much for realignment saving money. Given the current reality of a post-realignment world, this funding is necessary – in fact, more will be required. It is unfortunate, however, that the proponents of realignment were unable to foresee the strain it would put on local jails, despite having been warned repeatedly. Realignment has not actually solved anything. It has merely shifted the problem of prison overcrowding to local jails.

Realignment Support Funding. The budget includes $750,000 General Fund for the BSCC to provide assistance to local governments with the implementation of realignment. This is on top of the $8.9 million General Fund included in the Governor's Budget for the same purpose. So much for realignment saving money.

Local Public Safety

Facilitation of Local Realignment Implementation. The budget includes a handful of policy changes to help local law enforcement implement realignment by providing flexibility in the management of offender populations. One such change **increases the maximum number of early release days from 5 to 30** that a sheriff or police chief can apply to an inmate's term of incarceration when the number of inmates exceeds the bed capacity of the jail and the sheriff or police chief has petitioned the court for relief. Another change authorizes a county to contract with other entities of local government to house inmates in community correctional facilities. The budget also authorizes a correctional administrator to allow an inmate to participate in an electronic monitoring program, despite the inmate not having met minimum custody hold time requirements or being able to post bail, which will decimate the bail bond industry in most areas of the state. While they may make it easier for local law enforcement agencies to manage realigned offender populations, **overall these changes will result in additional unrehabilitated offenders being placed back on the streets where many of them will commit new crimes and create new victims.**

Setting Up Cities to Pay if Tax Initiative Fails. Reflected in the budget is the **elimination of statutory requirements for a county to hold a public hearing and give 45 days' notice** to each affected city, special district, school district, community college district, college, or university **before increasing booking fee rates**. Existing law authorizes counties to charge booking fees when state funding provided to offset county jail costs falls below a certain level. The change in notification requirements reflected in the budget sets up a scenario where **cities, schools, and special districts could end up paying costs they were not supposed to incur under realignment** with virtually no time to react to the cost increase. This could happen if the Governor's proposed tax increase initiative, which contains statutory protections for realignment funding, fails at the ballot box in November. If that happens, the state could eliminate the booking fees appropriation and claim it as savings, which would trigger the counties to charge booking fees. Without the public hearing and notification requirements, cities, schools, and special districts could be blindsided by increased booking fee costs. Due to the state of the economy, options to deal with the increased costs would be limited, but could include cities, school districts, and special districts making fewer arrests and/or sending fewer offenders to jail. This would not be good for public safety.

California Emergency Management Agency

Temporary Support for Victim Identification and Notification Everyday Network. The Victim Identification and Notification Everyday (VINE) Network provides a toll-free telephone hotline and a website through which victims of crime and other concerned citizens can check the custody status of offenders. To date, the VINE program has been funded through an American Recovery and Reinvestment Act (ARRA) Justice Assistance Grant (JAG) award received by the California State Sheriffs Association from Cal EMA's ARRA JAG funds. The ARRA JAG was one-time federal funding, and the program has ended. The budget includes $1.8 million Victim-Witness Assistance Fund in both 2012-13 and 2013-14 to continue funding the VINE program for two more years, giving the CSSA, Cal EMA, and CDCR time to identify a permanent funding source.

Department of Justice

False Claims Act Fund Transfer to the General Fund. On May 7, 2012, the Attorney General announced a settlement in a multi-state lawsuit against Abbott Laboratories. California joined other states and the federal government in seeking damages related to false claims made by Abbott Laboratories to Medicaid and other federal healthcare programs. California's share of the damages and penalties is $52 million, which will be divided among various stakeholders, including the Department of Health Care Services and the California False Claims Act Trust. The budget includes a transfer of $7.7 million in settlement proceeds from the False Claims Act Fund to the General Fund.

Increased Penalty Assessment for Crime Laboratory Operations. The budget reflects the elimination of $10 million in General Fund support for the operation of the Department of Justice's (DOJ) forensic laboratories. The funding is backfilled with DNA Identification Fund (DNA ID Fund) revenues **from an increase to the existing penalty assessment** on criminal convictions and traffic violations that feeds the fund. Currently, revenues from two different penalty assessments are deposited in the DNA ID Fund. The first is equal to $1 for every $10 of base fine and is split between the county and the state's DNA ID Fund. The entire amount of the second is deposited in the DNA ID Fund. Prior to enactment of SB 1006, the 2012-13 General Government budget trailer bill, the second penalty assessment was equal to $3 for every $10 of base fine. SB 1006 increased the second penalty assessment to $4 for every $10 of base fine.

In 2010, the second penalty assessment was increased from $1 to $3 to backfill a $41 million General Fund reduction in crime lab support. Revenues have not come in as expected. One possible explanation is the law of diminishing returns. Today, the total amount one pays when facing a fine for a criminal act or traffic infraction is typically three to four times the amount of the base fine. A simple traffic violation can result in a total payment of $400 to $500 or more. As more and more penalties, fees, and surcharges are assessed, fewer people are able to pay them. When a court finds that a defendant is unable to pay, the fine and any additional assessments can be reduced or eliminated. At some point, the revenue lost due to the reduction or elimination of fines and related charges will exceed the marginal gain due to increasing punitive assessments. If we have not reached that point yet, we may soon. It is questionable whether the penalty increase included in the budget will generate enough revenue to fully support DOJ's forensic laboratory operations.

Judicial Branch

Reduction of Trial Court Reserves. The budget includes language that limits the amount of reserves that each trial court can carry over from year to year to one percent of its operating budget. This limit will take effect in 2014-15. The budget also establishes a statewide reserve, equivalent to two percent of total trial court funding each year, to be distributed to trial courts by the Administrative Office of the Courts (AOC) for emergencies, as needed. The effect of this change will be to further centralize the administration of the trial courts at the state level and restrict each court's ability to plan for lean times and/or long-term projects. **It also creates a disincentive for trial courts to be efficient and to save money for a rainy day, since reserves will be mostly controlled at the state level and trial court reserves are continually ripped off.**

Reduction in General Fund Support for Trial Courts. The budget includes $525 million in General Fund savings due to a reduction in General Fund support for trial courts operations, all of which is offset by other funding sources in 2012-13. Of the $525 million, $410 million is one time, and $115 million is ongoing. The offsets would come from a requirement that each trial court spend down its existing reserves ($285 million) and a redirection of court construction funds resulting from a one-year delay in various court construction projects ($240 million). The $125 million ongoing General Fund reduction replaces the proposed trigger reduction of the same amount that was included in the Governor's Budget. It will be partially offset, at least for the next few years, by $50 million in redirected court construction funds, leaving a $75 million permanent spending reduction that the trial courts will have to operationalize, beginning in 2013-14.

Reduction in General Fund Support for the State Judiciary. The May Revision would have reduced funding for the state judiciary (including the Supreme Court, the Courts of Appeal, the Habeas Corpus Resource Center, and the Judicial Council) by $4 million to reflect an increase to the retirement contribution rates of State Judiciary employees. Instead, the budget includes a permanent $4 million unallocated General Fund reduction to the state judiciary and a $15 million General Fund reduction to the AOC, of which $10 million is permanent and $5 million is one time.

Court User Fee Increases. The enacted budget increases fees and assessments on court users by approximately $160 million per year. These fee increases partially offset the General Fund spending reductions described above. Specifically, the budget deletes the sunset provisions on fees that were established or increased from 2009 to 2010 (first paper filing, summary judgment motion, pro hac vice, telephonic appearance, parking penalty, court operations assessment), continuing approximately $110 million in revenues to the Trial Court Trust Fund (TCTF). In addition, it includes new fees and fee increases, providing new revenues to the TCTF (approximately $50 million) and the Appellate Court Trust Fund (approximately $1 million), as follows:

- *Fee for filing a will.* New $50 fee to deposit a will with the clerk ($2.2 million TCTF).
- *Jury deposit fee.* Increases jury deposit fee revenues from civil litigants wishing to retain their right to a jury trial by changing the existing $150 fee cap to a $150 flat fee and making the fee nonrefundable, even if the litigant does not end up having a jury trial ($11.7 million TCTF).
- *Motion, application, or any other paper requiring a hearing subsequent to the first paper filing fee.* Increases fee from $40 to $60 ($8.3 million TCTF).
- *Unlimited civil case first paper filing fee.* Increases fee from $395 to $435 ($21.1 million TCTF).
- *Complex case fee.* Increases the fee for each adverse party from $550 to $1,000 and the cap on total complex case fees from all adverse parties from $10,000 to $18,000 ($7.1 million TCTF).

- *Appellate first paper filing fee.* Increases the appellate court first paper filing fee (providing approximately $1 million in new revenue to the Appellate Court Trust Fund), as follows:

    - Notice of appeal in a civil case appealed to a court of appeal or petition for a writ within the original civil jurisdiction of a court of appeal – fee is increased by $120 (from $485 to $605).
    - Petition for a writ within the original civil jurisdiction of the Supreme Court or petition for review in a civil case in the Supreme Court after a decision in a court of appeal – fee is increased by $120 (from $420 to $540).
    - Party other than appellant filing its first document in a civil case appealed to a court of appeal, party other than petitioner filing its first document in a writ proceeding within the original jurisdiction of the Supreme Court, party other than petitioner filing its first document in a writ proceeding within the original jurisdiction of a court of appeal, or party other than petitioner filing its first document in a civil case in the Supreme Court after a decision in a court of appeal – fee is increased by $65 (from $325 to $390).

Court-Appointed Counsel Program. The budget includes a $4.7 million General Fund augmentation to support increased caseload and costs in the Court-Appointed Counsel (CAC) Program. The California Constitution requires the state to provide adequate representation for indigent appellants in noncapital cases in the courts of appeal. The CAC Program has experienced deficiencies in 2008-09, 2009-10, 2010-11, and 2011-12. The state has provided deficiency funding in each of those years. The $4.7 million increase is intended to fully fund the program in 2012-13.

Transportation

Road Funding Gets Ripped-Off. The state budget transfers $184 million in 2011-12 and $128.2 million in 2012-13 (and annually thereafter) of gas excise tax revenues to the General Fund. These revenues are supposed to go to the State Transportation Improvement Program (STIP), Local Streets and Roads (LSR), and the State Highway Operations and Preservation Program (SHOPP) and **NOT** to the General Fund. AB 105, Statute of 2011, reenacted the "Gas Tax Swap," which changed the tax structure on gasoline and diesel fuels. AB 105 was revenue neutral for consumers but made transportation funds more flexible to fund transportation-related General Obligation debt service, thus offsetting General Fund costs. Another benefit of the Gas Tax Swap was that "Prop 42" funding for highways and local roads was preserved.

With this budget, the STIP and LSR will each see a decrease of $81 million in 2011-12 and $56.4 million in 2012-13 and ongoing. The SHOPP will be decreased by $22.1 million in 2011-12 and $15.4 million in 2012-13 and ongoing. Cities, counties, and road construction advocates all opposed this policy shift which will result in less road maintenance and poorer driving conditions for Californians. **This is yet another example of Legislative Democrats going back on their word.**

Building New Wall of Debt. The budget includes an extension of $307 million in transportation related loan repayments and transfers $374.4 million in weight fee revenues to the General Fund in 2012-13 as a loan to help balance the state budget. These weight fee funds, which are above the amount needed to pay current debt service, would ultimately be used to offset transportation debt service in future years. At that time, the General Fund will be faced with a new wall of debt that needs to be repaid and current programs will need to be reduced to pay that debt. In addition, another $47.5 million in 2013-14 of weight fees will be transferred to the General Fund until the payment of transportation debt service is required. For fiscal year 2012-13, weight fees will also offset $603.6 million of transportation debt service.

Proposition 1B (Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006). The budget appropriates $3.1 billion ($1.8 billion carryover and $1.3 new appropriations) in Proposition 1B funds for project construction costs including; $992 million for corridor mobility, $774 million for trade corridors, $569 million for state-local partnerships, $351 million for State Route 99, $137 for major highway rehabilitation, $121 Intercity Rail, $81 million for State Transportation Improvement Program, $44 million for grade separations, and $16 million for local bridge seismic safety.

Public Private Partnerships. The Budget Act **does not** include funding for the Governor's Public Private Partnerships (P3) proposals for local and state sponsored projects on the state highway system ($2.6 million in reimbursements for Caltrans and $400,000 State Highway Account for the California Transportation Commission). These funds would have been used by both state entities to provide consulting services to evaluate P3 proposals, but Legislative Democrats continue to reject the input of the private sector into state controlled transportation projects.

Flawed High Speed Rail (HSR) Project Funded. Despite the fact that the state budget proposes to initially raise taxes by $8.5 billion or make $6 billion in devastating cuts to K-14 and higher education programs, the Governor and legislative Democrats believe that providing $8 billion for a poorly managed and unsound HSR scheme is a higher priority. The budget provides $8 billion in funding ($4.72 billion from Safe, Reliable High-Speed Passenger Train Bond Act of the 21st Century (Prop 1A) and $3.2 billion from federal trust funds) to begin construction of the High-Speed Rail project in the Central Valley referred to as the Initial Operating Segment (IOS). In addition, these funds would be used for intercity and commuter rail lines, urban rail lines, high-profile projects on the 'Bookends" in San Francisco and Los Angeles, environmental review and design activities, and administration and operational costs. Furthermore, the budget includes $705,000 Public Transportation Account funds for the Department of Transportation to provide staffing to coordinate with the High Speed Rail Authority (HSRA) and other local and regional rail operators to improve service on Northern California intercity rail lines.

The HSRA issued its latest business plan on April 2, 2012, which now relies on a “blended” system approach to try and reduce costs and expedite the project delivery timeline. Phase 1 of the project is now estimated to cost $68.4 billion but the HSRA has only identified $12 billion in available funding for the entire project. Unfortunately, the biggest problem still exists, which is no private sector interest in the project and no additional federal funding commitments. The “blended” system will not produce a statewide high speed rail system, but instead, a rail line though the Central Valley to connect to existing intercity rail lines in the Bay Area and Los Angeles that would be upgraded with Prop 1A funds. Unfortunately, this segment can’t be completed with existing resources since the IOS will need an additional $20 billion to extend the line from Bakersfield to Palmdale which will require federal or private participation. The Governor proposed to use AB 32 Cap and Trade revenues as a backstop if federal, local, or private support does not materialize. The Legislative Analyst’s Office raised concerns in its report, “Funding Requests for High-Speed Rail” due to **an independent study that had determined that the high speed rail project would initially be a net emitter of greenhouse gas (GHG) emissions and it would take approximately 30 years before the project would reduce any GHG emissions. Therefore, use of these funds may be illegal. Control Section 15.11 of the 2012-13 Budget Act specifies that Cap and Trade funding could not be used for this project for two years.**

This is not the High-Speed Rail plan that was sold to the voters in Proposition 1A, and it will likely be subject to legal challenge because it violates that voter approved initiative. Furthermore, it is outrageous that the Governor and legislative Democrats have chosen to cut vital programs like schools and public safety to balance the state budget while making this flawed and mismanaged project, which will result in hundreds of millions in increased debt service costs, a top priority.

More Motor Vehicle Account Loans and Fund Rip-Offs. The state budget abandons the Governor's January proposal to provide a $5-per-vehicle discount to vehicle owners who renew their vehicle registration using the less costly online or mail options, and instead proposes using the funds, plus reserves from the Motor Vehicle Account (MVA), to make a $432.2 million loan and a $65.8 million transfer to the General Fund. This is a disappointing change in direction. **There has been a continuing pattern in recent years of increasing fees on motorists, then spending the funds for purposes other than those for which the increases were intended.** Over the past eight years, non-commercial vehicle registration fees have increased 130 percent, commercial fees have increased by 144 percent, and driver's license fees have increased by 107 percent. Last year alone, non-commercial vehicle registration fees were increased by 23 percent. During the same period, $213.8 million was swept and $180 million was loaned from the MVA to the General Fund. The Governor's registration renewal discount proposal would have finally given something back to California motorists. Allowing California motorists to keep more of their own money would have helped to stimulate the economy. Instead, legislative Democrats decided to raid the MVA yet again. Including the loan and transfer reflected in this budget, **total funding ripped off from the MVA to prop up General Fund spending is almost $900 million over a four-year period.** Rather than supporting bloated General Fund programs, motorist fees should be reduced to a level that covers necessary MVA expenditures and nothing more. ***This is essentially a hidden tax increase.***

Resources, Environmental Protection, and Energy

Cap and Trade and Spend Program. This budget authorizes the expenditure of Cap and Trade Program “fees” (more appropriately a tax) estimated to generate $1 billion in revenues in 2012-13 through the auctioning of Greenhouse Gas emission allowances by the Air Resources Board as a market-based compliance mechanism. **Control Section 15.11 of the Budget Act authorizes the Department of Finance to spend at least $500 million to offset unspecified statewide General Fund programs to support AB 32 activities.** Interestingly, specific expenditures are not included in the Budget Act, but instead will be provided through a future expenditure plan that will be submitted by the Department of Finance 60 days prior to allocating funds for 2012-13. Furthermore, for the 2013-14 fiscal year, the Department of Finance will be required to provide another expenditure plan to the Legislature if a long-term expenditure plan is not approved by the Legislature by August 31, 2012.

This Cap and Trade program will cover approximately 600 of the state's largest greenhouse gas emitting stationary sources, including: public universities, local government facilities, and municipal utilities. The tax proceeds are expected to grow significantly in future years, to as much as $10 billion annually, as more Californians are impacted. Some of the programs that this new tax may be spent on, according to the Administration, include Clean and Efficient Energy, Low-Carbon Transportation, Natural Resource Protection, and Sustainable Infrastructure Development. The specifics of these programs are vague and the nexus between who will pay the costs and who will benefit from the programs is unclear.

With the passage of Proposition 26 in November 2010, taxes disguised as "fees" would no longer be able to be passed by a simple majority vote. Though AB 32 was passed in 2006, there are significant legal problems that remain with Cap and Trade program, especially if any portion of these monies is used for anything other than administering the plan. Unfortunately, the Democrat controlled Legislature has approved other “fees” that under Propositions 26 are truly taxes, such as, the SRA fee. Therefore, it is not surprising that **a significant amount of the Cap and Trade “fee” will be used for unrelated purposes, thus making it an illegal tax.**

State Responsibility Area (SRA) Fees. The Budget Act includes $84.4 million in new “fee” revenues authorized by AB X1 29 (Blumenfield/2011), which requires the Board of Forestry to establish a “fee” of up to $150 on inhabited structures within the SRA to pay for fire prevention activities. The Administration estimates collection of these revenues to begin in September of 2012 and will use them to backfill General Fund/administration costs of $50 million in 2011-12, and about $47.9 million in 2012-13. Of the $47.9 million in 2012-13, approximately $38.6 million will be used to backfill the department’s base General Fund costs on fire prevention activities with the remaining going to administrative costs. The additional $28.2 million that the Administration had proposed to be used to backfill emergency fund (E-Fund) costs was ***rejected*** by the Legislature because firefighting activities were not consistent with the fee established in AB x1 29. <u>However, the Administration will continue to collect the higher fee in 2012-13 in case they can find a new way to spend it.</u> Additional administration costs include $6.6 million for the Board of Equalization and $1.5 million for the California Conservation Corps. ***Pursuant to Proposition 26, this new "fee" should have been deemed a tax requiring a 2/3 vote because it supports general purpose programs such as public education, fuels management on public land, and the open-ended “other prevention projects."***

New Energy Program Investment Charge (EPIC) Program. The budget authorizes a new program and **new tax** on ratepayers which was created by the California Public Utilities Commission (CPUC) after the public goods charge (PGC) failed to get an extension in the Legislature. The new program will fund the development and deployment of clean technologies for electricity through 2020 with no direct benefit to ratepayers. **It should be noted that the PGC was a tax and was approved by a two-thirds vote of the Legislature, therefore, this program should have required the same vote**

threshold, in order to avoid a violation of Proposition 26. It did not. The budget will provide initial funding of $1.1 million to the California Energy Commission to develop a financial planning document for the administration of the new Energy Program Investment Charge (EPIC) program. This program will cost ratepayers $142 million annually.

Boaters Paying for State's Obligations under the Davis-Dolwig Act. The budget provides a continuous $10 million annual appropriation from the Harbors and Watercraft Revolving Fund (HWRF) to fund the state's General Fund obligation under the Davis-Dolwig Act for recreational, fish, and wildlife enhancements associated with the California State Water Project. The $10 million continuous appropriation from the HWRF would provide funding for operations and maintenance costs, standard capital costs, and the payment of previous state obligations. The state has not been providing its share of the costs (General Fund) for many years and, therefore, the state water contractors have had to absorb these costs and are currently owed over $200 million. **Of the $10 million, $2.5 million would go towards repayment of this debt which will take 82 years to repay.**

In addition, SB 1018 (Resources Omnibus Trailer Bill) of 2012, requires the Department of Water Resources to seek Legislative approval before incurring costs associated with state water project upgrades or needed improvements. For these costs, it's the intent of the Legislature to use Proposition 84 funding that was approved for this purpose. The trailer bill specifies that the HWRF and Proposition 84 funds would fulfill the state obligation which would likely place continued burdens on the state water contractors in future years to fund the state's share of capital projects once the $54 million in bond funding is gone. It's unclear if the contractors could eliminate the recreational component of a project if the state refused to fund its share again. In addition, the Department of Water Resources would be required to present, 60 days before final approval, details of the terms and conditions of long-term water supply contracts at an informational hearing in the Legislature. This is the first step in an attempt to bring the State Water Project on-budget.

This transfer of funding will negatively affect the Department of Boating and Waterways' program and **unfairly target boat owners to pay for these General purpose benefits.** This proposal has the support of state water contractors because it provides a steady flow of revenues to meet the state's obligations, however, the impact to the boating program will likely be severe and cause funding reductions for public and private marina loans and boating facility infrastructure.

Beverage Distributors Become State Bankers. The 2012-13 budget shortens the redemption timeframe for beverage distributors making them statutorily obligated to remit the California Redemption Value (CRV) to the state even before receiving the payment from retailers thereby indirectly becoming the banker loaning money to the program. This was never the intent of the program, and it is inconsistent with the underlying public policy that has guided the payment schedule since program inception in 1987. Distributors will be required to submit beverage container redemption payments to the Department of Resources Recycling and Recovery (CalRecycle) by the last day of the first month after sale instead of the last day of the third month. These increased payments will mean 13 payments in 2012-13 and 12 payments thereafter per fiscal year. This additional payment in 2012-13 will allow the Administration to decrease the General Fund loan repayment to the Beverage Container Recycling Fund by $161.7 million and only repay $10 million in 2012-13.

Suction Dredge "Cleanup" Language. Last year, AB 120 (Resources Omnibus Trailer Bill) of 2011 included language that created a requirement that prohibited the use of vacuum or suction dredging equipment until June 30, 2016 or until the Director certifies that the new regulations fully mitigate all identified significant environmental impacts. The 2012-13 Resources Omnibus Trailer Bill (SB 1018, 2012) makes the <u>prohibition more restrictive</u> by striking the June 30, 2016 expiration date on the suction dredging ban and requiring a new environmental review to be completed by the Department of Fish and Game in order for suction dredging to commence again. The department is required to consult with other agencies and report to the Legislature on statutory changes or authorizations required to develop suction dredge regulations along with recommendations on a fee structure to pay for the administration of the program. **It should be noted that the requirements of this environmental review are so restrictive that it's unlikely the department will ever be able to certify new regulations.**

Sustainable Parks Proposal. The Budget Plan contains numerous mechanisms to help the Department of Parks and Recreation (DPR) keep as many state parks open as possible given the recent ongoing General Fund reductions. Most of this proposal is supportable with the exception of the use of Off-Highway Vehicle Trust Funds (OHVTF). These mechanisms include:

- **Funding flexibility to become more entrepreneurial** by allowing DPR to increase funding from the State Parks and Recreation Fund by $4.3 million and shifting another $11 million from its base budget to a continuous appropriation to provide the department additional flexibility to implement new projects and/or new programs that generate additional revenue. Fifty percent of the new revenues would stay within district that created the project. This will be a two-year pilot program.
- **Personnel classifications that allow** the department to direct peace officers to the highest priority workload and allow non-peace officers to administer non-law enforcement tasks.
- **Collecting entrance fees in more locations** and utilize concession agreements in as many areas as practical.
- **Varied funding sources** including an opt-in fee and other alternatives to be determined in the future (Per Supplemental Report Language).
- **A vehicle license plate** for state parks with revenues deposited into a newly created California State Parks Account within the Specialized License Plate Fund.
- **Transfers $7 million from OHVTF programs to** non-OHV parks on a one-time basis. **The Governor vetoed this amount down from the $21 million proposed by Legislative Democrats.** However, this will still result in a $10 million reduction in local OHV activities in 2012-13 since the budget does not contain adequate expenditure authority for those programs. The $14 million that was vetoed will go to the OHVTF for use in future years. The OHV program at state parks is a successful program that is fully self-supported by OHV gas taxes, park entrance fees, and vehicle registration fees.
- **Provides existing Prop 84 bond funds, $13 million, for a revenue generation program** through two-year revenue generation targets within each park district. All revenues generated from projects shall be deposited into newly created California State Park Enterprise Fund. Districts that exceed their revenue projections shall receive 40 percent of the revenues generated. The remaining funds shall be used for capital improvement projects and a revolving loan program.
- **Transfers $3 million (one-time) from the Alternative and Renewable Fuel and Vehicle Technology Fund (AB 118) for Use by DPR.** These funds are derived from car and boat registration and smog abatement fees to promote the development of alternative fuels and fleet modernization programs to reduce "global-warming". Senate Republicans did not support AB 118 (Nunez) of 2008. Furthermore, California voters already said no to increases on their vehicle registration to fund state parks by rejecting Proposition 21. This proposal circumvents the will of the people. **The Governor vetoed $7 million of the $10 million proposed by Legislative Democrats.**

Regional Water Quality Control Boards. The budget reorganizes the regional water boards by reducing the number of board members from nine to seven, eliminates categorical board members associations, and updates conflict of interest rules. It should be noted that the agricultural community supports this proposal, however, the Regional Council of Rural Counties opposes the elimination of the "local governments" board category. However, under federal government regulations, most county employees are disqualified so appointments are very difficult, if not impossible at this time.

General Government

California Department of Veterans Affairs (CalVet)
The CalVet budget includes funding to continue the expansion of veterans homes in the state. Despite the Governor's original proposal to indefinitely delay the opening of the newly built homes in Redding and Fresno, bipartisan legislative support for opening the homes led to an additional $4.2 million in the final budget to begin hiring staff at these facilities in April 2013. Resident admissions are expected to begin in October 2013. The budget also reflects a reduction of $3 million related to an unintended delay of several months in opening the skilled nursing facility at the Greater Los Angeles-Ventura County veterans home. That facility is now expected to open this summer. Besides funding for veterans homes, the budget package maintains the previous amount of funding for County Veterans Services Offices. Budget language also requires CalVet to develop an incentive-based formula for allocating funds to these offices, with the goal of helping more veterans receive maximum federal compensation and pension benefits.

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. After debt service and pass-through payments are made, the remaining property tax revenues and assets are to be liquidated and distributed as property taxes to cities, counties, school and community college districts, and special districts under existing law. Providing additional property tax funding for education yields a General Fund savings by reducing the state's General Fund contribution to Proposition 98. Legislative Republicans opposed the elimination of RDAs because they are important tools to local governments to revitalize areas that are physically or economically blighted and to spur economic development.

The 2012-13 Budget Act relies on the following fiscal estimates as solutions to the General Fund's $15.7 billion budget deficit.

RDA Offsets	2011-12	2012-13	2013-14	Comments
Property Tax Increment	$133	$1,676		Occuring on the natural as a result of ABX1 26. Department of Finance estimates annual offsets of approximately $1 billion.
Asset Liquidation		$1,479	$600	Trailer bill proposed to "motivate" or extort local action to liquidate assets and distribute to cities, counties, schools, and special districts.
Total "Solutions"	**$133**	**$3,155**	**$600**	

In January the Governor's Budget proposed trailer bill language to address the Administration's concerns that ABX1 26 does not provide deadlines for liquidation and distribution. The final trailer bill established a stringent process for the Department of Finance to review and approve Recognized Obligation Payment Schedules (ROPS), including specific deadlines for treatment of RDA assets and housing-related assets. According to the Department of Finance, if successor agencies promptly pay the determined amount, the following benefits are provided:

1) Loans from cities and counties to their RDAs currently ineligible for repayment would be deemed eligible for repayment beginning in 2013-14 (potential for additional $4 billion to cities and counties).

2) The budget would allow successor agencies to use proceeds from bonds sold before January 1, 2011 to execute new contracts consistent with the requirements of the bond covenants.

3) The budget would allow land and other physical assets not needed for enforceable obligations of the former RDAs to be transferred by the successor agency to the city or county that created the RDA and used for economic development, without compensation to the affected taxing entities.

The Governor's summary of the redevelopment issue highly praises the benefits bequeathed upon cities, counties, and successor agencies if they comply with Department of Finance determinations. It does not, however, prominently display the massive increase of power and autonomy provided to the Department of Finance to mandate and ensure "compliance," which garnered significant Republican opposition. The most egregious power-grabs include:

- The Department of Finance can amend, modify, or reject anything on a ROPS approved by a successor agency or oversight board, without any opportunity for local agencies to appeal those decisions. This includes any bond proceeds allowed to be retained under benefit #2 (above).
- This bill creates a punitive penalty of ***$10,000 for each day*** that a ROPS is late to the Department of Finance. This penalty is excessively punitive, especially for smaller rural counties that may not have the staff necessary to meet the strict deadlines set forth in the bill.
- Under the "clawback" provisions, this trailer bill allows the Department of Finance to direct the Board of Equalization to withhold sales and use tax revenues from cities and counties and the county auditor-controller to withhold property tax revenues to pay for Department of Finance decisions, with no ability for local entities to appeal those decisions. This will likely have a significant negative impact on local public safety and health and human services programs.

Last year, Republicans raised concerns that ABX1 27 was an unconstitutional extortion of cities and counties to retain redevelopment in exchange for a $1.7 billion General Fund solution. The California Supreme Court, indeed, found ABX1 27 to be unconstitutional. Though this trailer bill is much more subtle, it still contains the elements of extortion. It provides limited benefits related to bond proceeds, RDA assets, city/county loans, and housing assets in exchange for mandated compliance under the iron fist of the Department of Finance. Bottom line is that it looks like legislative Democrats and the Governor have made a bad situation worse with this bill.

Additionally, legislative Democrats and the Governor should be concerned that the "balanced budget" is, again, built upon rosy assumptions. The Legislative Analyst's Office significant concerns regarding the validity of the budget assumptions.

- <u>The Department of Finance estimates $1.8 billion of property tax increment to be distributed to schools:</u> *"We are concerned, however, that the administration is overstating the amount of property tax revenues from former RDAs that will be distributed to schools in 2011-12 and 2012-13. Our rough estimate is that this causes the state budget problem to be around $900 million greater than assumed by the administration…"*
- <u>The Department of Finance estimates $2.3 billion of liquid assets to be distributed to schools:</u> *"We find that the administration's estimate of liquid assets available for distribution is subject to considerable uncertainty. Part of our concern relates to the likelihood that lawsuits will delay distribution of these funds."* And, the likelihood of lawsuits is high.

Governor's Office of Business and Economic Development

The Governor's Office of Business and Economic Development (GO-Biz) serves as the lead state entity for economic strategy and marketing of California on issues relating to business development, private sector investment, and economic growth. The budget expands the authority of local governments to attract businesses by targeted property tax rebates.

Previously, state law allowed local governments to provide property tax rebates for large manufacturing facilities, those with capital investments greater than $150 million. Trailer bill language (AB 1466, 2012) will allow local governments also to provide those rebates for research and development facilities with capital investments greater than $250 million. The Department of Finance indicates that this expansion would not impact school district taxes and is at the discretion of local officials who can best gauge the community economic impact.

Allowing local governments the flexibility to offer property tax rebates to manufacturing facilities and research and development facilities could help them to entice these facilities to locate within the local government's jurisdiction. It would also likely reduce the amount of property tax rates paid by those facilities in those locations. Given the state's comparatively high tax burden and hostile regulatory environment, any level of financial rebates could be enticing to manufacturing or research and development facilities. However, this expansion would only be effective for one year, which would likely assist very few facilities. A better approach would be to provide broader flexibility statewide for a longer period of time to maximize participation throughout the state.

Commission on State Mandates

The Commission on State Mandates is a quasi-judicial agency that hears test claims to determine whether local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The Constitution requires the Legislature to either fund or suspend specified mandates in the annual Budget Act.

- *Funded Mandates.* The budget appropriates $48.8 million General Fund to fund and maintain 13 public safety and property tax collection mandates.
- *Suspension of Mandates.* The budget suspends 56 different mandates, covering health and human services topics, elections, public safety, open meetings, animal adoptions, and others, resulting in General Fund savings of $728.8 million. Approved trailer bill would suspend these mandates for three years, through 2014-15.
- *Deferral of Pre-2004 Mandate Obligations.* A decrease of $99.5 million in 2012-13 as a result of deferring the 2012-13 payment for mandate costs incurred prior to 2004-05. These payments will also be deferred in 2013-14 and 2014-15.

In 2005, the state owed approximately $1 billion to local governments to pay for mandate claims that had accumulated through 2004-05, and passed AB 138 (2005, Budget) to establish a 15-year payment plan for that obligation from 2006-07 through 2020-21. Except for one year, the state has deferred payment on these accumulated claims every year since 2006-07, leaving more than $900 million to be paid over six years (2015-16 through 2020-21). ***Will these obligations ever be paid?*** If chronic budget deficits continue indefinitely and this deferral solution continues to be "low-hanging fruit" each year, it is likely that legislative Democrats would pass another bill to extend the 15-year payment plan beyond 2020-21.

National Mortgage Settlement

In February 2012, 49 state attorneys general and the federal government reached agreement on a joint state-federal settlement with the country's five largest loan servicers (Ally/GMAC, Bank of America, Citi, JPMorgan Chase, and Wells Fargo) that will provide as much as $25 billion in relief to distressed borrowers and direct payments to states and the federal government. Our analysis of the May Revision includes a detailed description of the settlement.

Of the $25 billion total, approximately $18 billion will come to California and California homeowners. Most of that amount will go directly to homeowners to reduce principal amounts, refinance loans, allow forbearances, and provide cash payments to borrowers who have been foreclosed upon. The State of California has received $410.6 million "to repay public funds lost as a result of servicer misconduct, fund housing counselors, legal aid, and other similar purposes determined by state attorneys general." The May Revision proposed to use $292 million from the National Mortgage Settlement to backfill various General Fund programs and pay housing bond debt over a three-year period. **However, the final budget spends the entire $410.6 million over two years.**

The budget provides $198 million of National Mortgage Settlement funds to pay housing bond debt service for programs funded with Proposition 46 and 1C housing bonds that provided homeowner assistance. However, while the Attorney General's Office and the Department of Fair Employment and Housing (DFEH) may participate in housing-related activities, it is not clear that the following expenditures will do anything to help keep homeowners in their homes:

- Loaning $100 million to the General Fund "to be used to reimburse the General Fund."
- $41.1 million paid into the Unfair Competition Law Fund to offset various Department of Justice (DOJ) costs.
- $44.9 million for DOJ's Public Rights and Law Enforcement programs related to public protection and consumer fraud enforcement and litigation.
- $8.2 million for DFEH to prevent and eliminate unlawful discrimination.
- $18.4 million for DOJ to support homeowner counseling and for the Office of the California Monitor to oversee compliance with the settlement.

Given the apparently tenuous nexus between the settlement documents and the proposed use of funds, it would be appropriate to institute a little bit of transparency for this issue. However, the budget does not reduce the departmental budgets for DOJ and DFEH to account for these offsets, but instead facilitates the offset using "off-budget" accounting mechanisms, similar to the mechanisms proposed to account for the $500 million of offsets proposed under the new Cap and Trade Program.

Conclusion

The bottom line is that (1) the budget uses these funds for purposes other than to help Californians stay in their homes, (2) these funds backfill General Fund programmatic spending on Public Employee benefits and Welfare Programs, and (3) this type of "behind the scenes budgeting" promotes a lack of transparency.

Trigger Cuts Summary

Trigger Options (in Millions)	
Proposition 98 - A reduction of this magnitude would force a K-12 funding decrease worth about three weeks of instruction. The savings would be achieved through a reduction in the Proposition 98 minimum guarantee resulting from the lower revenues, and by replacement of existing Proposition 98 funding for K-14 programs with funding for G.O. bond debt service and the Early Start program, neither of which is currently funded within Proposition 98.	$5,353.8
University of California - Savings may be offset by Cal Grant cost increases if the universities raise tuition.	$250.0
California State University - Savings may be offset by Cal Grant cost increases if the universities raise tuition.	$250.0
Developmental Services - The Administration has not specified how these savings would be achieved.	$50.0
Revision to mitigate the negative impacts of the 2011 public safety realignment would be eliminated.	$20.0
Department of Forestry and Fire Protection - The department's firefighting capabilities would be reduced substantially. The emergency air response program would be reduced, and fire stations would be closed.	$10.0
Flood Control - Department of Water Resources would be cut, which would reduce channel and levee maintenance and floodplain mapping.	$6.6
Water Safety - Grants to local governments for water safety patrols would be	$5.0
Parks and Rec/Fish and Game - 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	
Fish and Game: Non-Warden Programs	$2.5
Park Lifeguards	$1.4
Fish and Game: Wardens	$1.0
Park Rangers	$0.1
Department of Justice	$1.0
Total Ballot Trigger Reductions	$5,951.4

Governor's Vetoes

Vetoes to AB 1464 - 2012 Budget Act

(Dollars in Thousands)

Department/Issue Title	General Fund	Other Funds
Elimination of the Office of Privacy Protection	$246	$190
Department of Transportation—State Funding of Local Highway Project Development	0	4,545
Department of Transportation—Cap on Project Design Contracting	0	0
Energy Resources Conservation and Development Commission—Fund transfer	0	(7,000)
Department of Fish and Game—Fish and Game Preservation Fund and Salton Sea Restoration Feasibility Study	0	0
Department of Parks and Recreation—Sustainable Parks Proposal	0	31,000
State Water Resources Control Board—Provisional Language to Reduce the Number of Regional Boards	0	0
Public Health—Nursing Home Administrator's Program Plan	0	0
Department of Public Health—Public Health Laboratory Director Training Program	500	0
State Hospitals—Quarterly Hiring Plan Update and Adult Education Discretionary Program	0	0
Department of Education—State Operations for the Early Mental Health Initiative	85	0
Department of Education—Early Mental Health Initiative	15,000	0
Department of Education—State Preschool	29,972	0
Department of Education—Child Nutrition Funding for Non-LEAs	10,100	0
UC—Provisional Earmarks to Provide Flexibility	0	0
Hastings—Provisional Language for Retirement Funding	0	0
Department of Justice—Crime Statistic Reports mandate	1,800	0
Total	**$57,703**	**$35,735**

Vetoes to AB 1497 - 2012 Budget Act

(Dollars in Thousands)

Department/Issue Title	General Fund	Other Funds
Judicial Branch—Redirection of Funds to Support Trial Courts	$0	$0
Department of Social Services—IHSS Administration	4,700	0
Department of Social Services—CalFresh Administration	23,000	31,000
Department of Education—Migrant Education Audit Funding and Positions	0	105
Department of Education—California School Information Services	886	0
Department of Education—Child Care Reductions	20,000	0
Department of Education (Proposition 98)—Advancement Via Individualized Determination	(8,100)	0
UC—Provisional Earmarks to Provide Flexibility and Provisional Language for Retirement Funding	1	0
CSU—Provisional Earmarks to Provide Flexibility and Provisional Language for Retirement Funding	0	0
Student Aid Commission—Cal Grants: Across-the-Board Reduction of Awards by 5 percent	22,600	0
Student Aid Commission—Provisional Language Authorizing New Warrants for the Loan Assumption Programs	0	0
TOTAL	**$71,187**	**$31,105**

2011-12 Budget & Trailer Bill List

Budget Bills		
Bill Number	**Subject**	**STATUS**
SB 1006	**General Government** Makes various statutory changes, including allocation authority related to the National Mortgage Settlement, repealing airport fee audits, increasing penalties on criminal convictions and traffic violations to support forensic laboratory operations, and stealing gas excise tax revenues from transportation projects for the General Fund.	Chaptered
SB 1008	**Health Coordinated Care Initiative** Implements the Governor's Coordinated Care Initiative (CCI), in which Medi-Cal "dual eligible" enrollees would receive both health care and long-term support services (LTSS) through Medi-Cal managed care plans. The bill would also authorize a one-time provider cash payment deferral gimmick of $711 million General Fund in 2012-13.	Chaptered
SB 1009	**Mental Health Realignment** Completes the realignment of community mental health programs from state administration to the counties, including by transferring state oversight functions from the Department of Mental Health to the Department of Health Care Services and other departments. No associated savings.	Chaptered
SB 1013	**Child Welfare Services Realignment** Clarifies county responsibility for child welfare and foster care services and including changes in sharing ratios between federal and county, identifying additional reporting requirements for realigned child welfare programs, creating a level of flexibility for non-entitlement programs, and expanding foster care to include those youth up to age 21, increasing expenditures by more than $50 million annually.	Chaptered
SB 1014	**Alcohol & Drug Programs Realignment** Includes policy changes consistent with realigning the state's substance abuse treatment programs to counties. Although the bill would require the consolidation of drug and alcohol programs, there are no associated reductions in administration costs.	Chaptered
SB 1015	**Tax Enforcement** Makes various statutory changes that change the rules under which the Franchise Tax Board can issue wage garnishments, repeal the statutes that govern the state's participation in the multi-state tax compact, and expanding the Financial Institutions Records Match program to include the Board of Equalization and Employment Development Department.	Chaptered
SB 1016 Ch 38/2012	**Education** Enacts statutory and fiscal changes necessary to implement the budget package crafted by Legislative Democrats, including provisions affecting the Proposition 98 guarantee, K-14 apportionments and deferrals, education trigger cuts ($5.9 billion) and shifts, school facility developer fees, and funding for child care and preschool, reimbursable state mandates, charter schools, the settlement of CTA v. Schwarzenegger, and student financial aid, among others.	Chaptered

Budget Bills		
Bill Number	**Subject**	**STATUS**
SB 1018	**Resources & Environmental Protection** The Omnibus Natural Resources trailer bill to the 2012-13 Budget Bill. This measure includes new taxes on utility ratepayers, Cap and Trade fees on businesses, inappropriate transfers of special funds to General Fund programs, and other areas of concern.	Chaptered
SB 1020	**Realignment Permanent Finance Structure** Repeals the temporary program and funding superstructure established in 2011 to implement Realignment and replaces it with a permanent superstructure. Establishes cost and funding protections for the state and for local entities affected by Realignment that are similar to those included in the Governor's proposed tax increase initiative slated for the ballot in the November 2012 presidential election.	Chaptered
SB 1021	**Public Safety & Judicial** Increases fees on court users, prohibits the Division of Juvenile Justice (DJJ) from extending a ward's parole consideration hearing date, eliminates civil commitments to prison for narcotics addiction, expands existing programs for female offenders and mentally ill parolees, implements the Governor's reorganization of the Department of Corrections and Rehabilitation (CDCR), authorizes the sale of a youth correctional facility, and modifies several statewide programs to conform to the 2011 Realignment Legislation Addressing Public Safety (Realignment).	Chaptered
SB 1022	**Public Safety: Capital Outlay** Extinguishes approximately $4.1 billion in lease-revenue bond (LRB) authority established by the Public Safety and Offender Rehabilitation Services Act of 2007 (AB 900) for construction of thousands of infill, reentry, and medical prison beds. It also authorizes $1.3 billion in new LRBs to build flexible housing for various inmate subpopulations ($810 million) and to build local jail facilities to help counties manage their offender populations ($500 million).	Chaptered
SB 1023	**Public Safety Realignment** Makes various changes to Realignment, including adding a number of new crimes to the list of jail felonies it created, changing several jail felonies back to prison felonies, correcting errors and conflicts in the law created by Realignment, and clarifying numerous provisions of law made unclear by Realignment. Continues Realignment, a dangerous public safety plan.	Chaptered
SB 1029	**High Speed Rail** Provides $8 billion in appropriations to begin construction of the High-Speed Rail in the Central Valley.	Chaptered
SB 1033	**Cash Management** Creates a new program that would allow local agencies to deposit local funds into a state fund for the purpose of increasing the level of internal borrowing resources for the state and allowing the state to roll over deficits from one fiscal year to the next.	Chaptered

Budget Bills		
Bill Number	**Subject**	**STATUS**
SB 1036	**Human Services: Coordinated Care Initiative** Implements the Governor's Coordinated Care Initiative (CCI) (with regards to In-Home Supportive Services), in which Medi-Cal "dual eligible" enrollees would receive both health care and long-term support services (LTSS) through Medi-Cal managed care plans. Creates the In-Home Supportive Services (IHSS) Employer-Employee Relations Act for purposes of recognizing IHSS union representatives as eligible to bargain with the newly created Statewide Authority for wages and compensation of IHSS employees, driving up costs for the program. The state-level collective bargaining is effective in counties participating in the dual demonstration project (eight counties beginning in March 2013). Phases in the initiative over a three year period, beginning in 2013. As more counties transition into the program, costs for wages within the IHSS program are likely to increase as state-level bargaining for wages will create a "race to the top" for compensation across the state.	Chaptered
SB 1038	**Boards & Commissions** Makes statutory changes to various boards and commissions, including eliminating the Fair Employment and Housing Commission, revising statutes and expanding duties related to the Commission on the Status of Women, eliminating various boards and task forces, and revising the make-up of the Unemployment Insurance Appeals Board. Violates the CA Constitution, which prohibits the elimination of state commissions on an urgency basis.	Chaptered
SB 1041	**Human Services** Enacts statutory changes necessary to implement the 2012 Budget. It generates savings in the CalWORKs program through a new 24 month time limit for services, but adds a new exemption to the program (allowing more recipients to receive welfare checks while not participating in work requirements), and reduces the administrative funding as a result of this exemption. The 2012 Budget spends $800 million more than the Governor's January CalWORKs reform and In-Home Supportive Services reductions.	Chaptered
AB 1464 Ch 21/2012	**Budget Act** Reflects the Democrat's majority vote budget scheme for 2012-13. According to the Governor, it is a structurally imbalanced budget now and in the future. It appears to rely on future tax increases and gimmicks for 90% ($14.5 billion) of the $16.2 billion of budget defcit solutions, and only 10% ($1.7 billion) of real programmatic spending reductions. If the voters do not enact a 7-year $47 billion tax increase in Novemeber this budget will trigger $6 billion of devasting cuts to K-14 and Higher Education programs.	Chaptered
AB 1465	**Transportation** Transfers gas excise tax revenues to the General Fund, provides General Fund relief and loan flexibility related to transportation debt service payments, and loans Motor Vehicle Account (MVA) funds to the General Fund.	Chaptered
AB 1467	**Health** Makes numerous changes to health care programs in order to implement the 2012 Budget Act. Breaks previous agreements with hospitals by ripping off $293 million in hospital payments.	Chaptered

Budget Bills		
Bill Number	**Subject**	**STATUS**
AB 1470	**State Mental Hospitals** Makes statutory changes necessary to eliminate the Department of Mental Health and create the Department of State Hospitals (DSH) in its place. The bill also expands a program that shortens the process of treating criminal offenders deemed Incompetent to Stand Trial (IST).	Chaptered
AB 1472	**Developmental Services** Enacts a variety of changes to programs operated by the Department of Developmental Services.	Chaptered
AB 1484	**Redevelopment** Makes a variety of changes to redevelopment law, including (1) providing a massive increase in authority to the Department of Finance to implement the liquidation of real and liquid assets and transfer to various taxing authorities, (2) various changes to reporting and timelines to expedite the liquidation and transfer of cash and real assets to cities, counties, schools and special districts, (3) allowing bond proceeds derived from bonds issued on or before December 31, 2010 to be used solely for the purpose for which the bonds were sold, consistent with the original bond covenants, (4) ensuring the repayment of certain RDA loans, (5) establishing provisions for long-term property management plans, (6) retaining funds for low and moderate income housing projects, (7) allowing the Department of Finance to withhold property tax or sales and use tax from local entities to reconcile previous RDA asset transfers, and (8) clarifying the treatment of pass-through agreements. Causes more harm to local goverments and the struggling economy.	Chaptered
AB 1494	**Healthy Families Program** Shifts all children from the Healthy Families Program (HFP) to the Medi-Cal Program, effectively eliminating HFP and destroying the health care system for 880,000 children.	Chaptered
AB 1497 Ch 29/2012	**Budget Bill Junior** Amends the main budget bill to increase funding for IHSS, appropriate National Mortgage Settlement Funds, fund High Speed Rail, fund charter school growth, replace $800 million in General Fund support for CalGrants with the same amount of federal TANF funds, reduce retireee health care costs through a federal rebate program, and unnecessarily spend $300 million for a new Child Well-Being program. Makes a variety of other budgetary changes.	Chaptered
AB 1499	**Elections** Changes the order in which initiative bond measures and initiative constitutional amendments will appear on the statewide ballot. Move Governor Brown's tax increase proposal from the eighth position in the current ballot order to the number two position on the November, 2012 General Election ballot. This bill violates Proposition 25 in that it has nothing to do with implementing the budget.	Chaptered

Budget Bills		
Bill Number	**Subject**	**STATUS**
AB 1502	**Higher Education (UC & CSU)**	Chaptered
Ch 31/2012	Reflects a June 24, 2012, agreement between the Governor and Legislative Democrats to augment General Fund support for the University of California Retirement Plan (UCRP) by $38 million, to a total of $90 million, and provide conditional appropriations of $125 million each to UC and CSU in 2013-14, contingent on voter approval of the Governor's proposed tax hike and the segments' continuation of 2011-12 student fee levels through 2012-13.	
AB 1485	**2011-12 Supplemental Appropriations**	Chaptered
	This is the annual supplemental appropriations bill. It appropriates $1.1 billion General Fund to pay deficiencies incurred by the Department of Health Care Services ($759.6 million), the Department of Corrections and Rehabilitation ($295.4 million), and the Department of State Hospitals ($41.8 million), and to reimburse unanticipated county costs associated with homicide trials ($125,436).	

Senate Republican Fiscal Staff Assignments

Seren Taylor, Fiscal Director
Trish Lenkiewicz, Budget Committee Assistant

Contact Number: (916) 651-1501

Assignment Area	Consultant
Education	Cheryl Black
Public Safety, Judiciary, Corrections	Matt Osterli
Transportation, Energy & Environment	Rocel Bettencourt
Health	Kirk Feely
Human Services, Public Employees Retirement	Chantele Denny
Revenue, State & Local Government, Taxes	Joseph Shinstock

For more information, please visit our website at http://cssrc.us/publications.aspx