Governor's Budget



May Revision 2007-08

Introduction

The Governor's Budget for 2007-08, as proposed in January, eliminated the net operating deficit (the balance between ongoing revenues and expenditure, after accounting for various one-time revenues and expenditures, most significantly the $1.6 billion that was proposed to pre-pay the Economic Recovery Bonds [ERBs]), held spending growth to 1.0 percent and maintained a reserve of $2.1 billion.

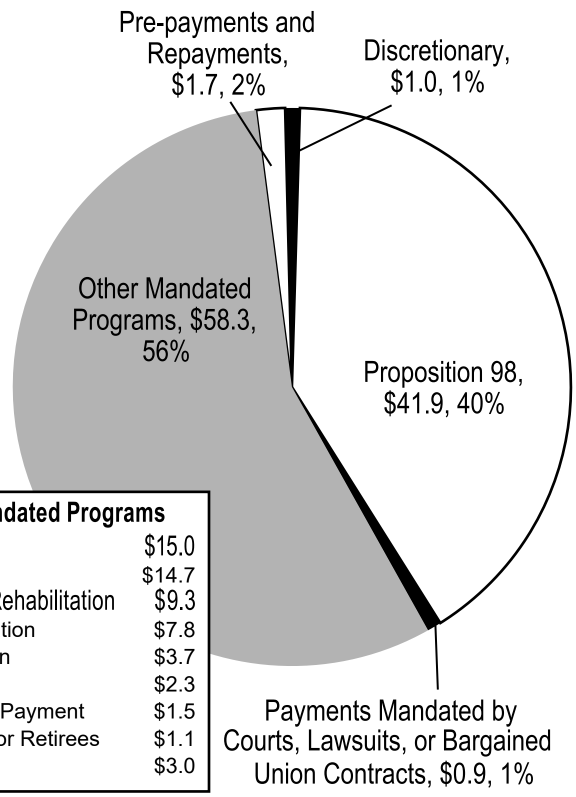
The May Revision continues the Governor's commitment to restraining the growth in spending, pre-paying debt, eliminating the net operating deficit, not raising taxes and maintaining an adequate reserve. As such, the Governor's May Revision includes several measures to further reduce spending, generate additional revenues from publicly-owned assets and provide a reserve of $2.2 billion.

While the net operating deficit of $1.4 billion is not eliminated entirely even with these changes, this reflects major progress as compared to the $4.4 billion that was anticipated for 2007-08 at the time the Governor signed the 2006 Budget Act and reflects a reduction of 92 percent from the projected deficit when the Governor took office.

Restraining Spending Growth While Protecting Priorities

The May Revision proposes to increase General Fund expenditures in 2007-08 by $1.5 billion or 1.5 percent over the level of spending in 2006-07. As Figure INT-01 shows, most General Fund spending is non-discretionary. Of the total spending proposed, $1.7 billion, or 2 percent, is for pre-paying debt and only $1.0 billion, or less than 1 percent is proposed for policy choices. The remainder is required either by the constitution, federal laws, statutory entitlements, binding labor agreements or court orders.

Figure INT-01
2007-08 General Fund Expenditures: $103.8 Billion
(Dollars in Billions)



Other Mandated Programs	
Other HHS	$15.0
Medi-Cal	$14.7
Other Corrections/Rehabilitation	$9.3
Other Higher Education	$7.8
Other K12 Education	$3.7
Judicial	$2.3
Prop 42 Scheduled Payment	$1.5
Health and Dental for Retirees	$1.1
All Other	$3.0

Consequently, the only way to hold down spending is by approving very few discretionary spending increases while changing state law to reduce the costs of programs. The Governor's Budget proposed legislation to reduce various state programs for total savings of $2.5 billion. The May Revision proposes additional program reductions for $430 million in additional savings, of which $230 million will be in the budget year, with the remainder occurring in the current year.

Despite this extreme restraint in overall spending growth, the May Revision continues to protect key priorities by fully funding the state's Proposition 98 obligation to education, fully funding the Governor's compacts with higher education and the judiciary, fully funding public safety, continuing the commitment to reform the prison system and protecting economic growth by not raising taxes.

Summary of Major General Fund Changes

Figure INT-02 below reflects major General Fund changes since the Governor's Budget was released in January.

Figure INT-02

Major General Fund Changes

(Dollars in Millions)

		Total Reserve
Total June 30, 2008 Reserve Projected as of January 10		**$2,085**
(Includes $1.495 billion in Budget Stabilization Account)		
Baseline Adjustments Since Governor's Budget		-$1,916
Proposals to Close Budget Gap		
Sell EdFund	$980	
Transfer Tobacco Securitization Reserve to General Fund Reserve	600	
Use Additional Spill-Over to Pay for Home-to-School Transportation in 2006-07	200	
Suspend SSI/SSP COLA	185	
Eliminate Williamson Act Subsidy	40	
Probation Subsidy	25	
Total, Proposals to Close Budget Gap		$2,030
Total Reserve at May Revision		**$2,199**

Maximizing the Value of Public Assets

The May Revision also reflects the administration's desire to think outside the box to find budget solutions that are beyond program reductions and tax increases. Specifically, the May Revision proposes ways to expand revenues by maximizing the value of underperforming public assets.

- The May Revision proposes the sale of EdFund—California's student loan guarantee agency. The EdFund competes in the private market as a student loan guarantor to banks and other financial institutions. EdFund does not offer direct student loans, set loan rates, or provide revenues to the General Fund. Student loan interest rates are regulated by the federal government; thus students will not be affected by this proposed transaction. Analysis shows that there is major potential for a private firm to improve earnings from the EdFund which makes EdFund an attractive public asset that could be maximized to benefit taxpayers. The May Revision assumes a net one-time increase in revenue from this sale of $980 million.
- The administration is requesting that the Legislature consider selling a long-term license to operate the state lottery. The lottery has never fulfilled its promise to provide a growing source of revenues to education and it substantially underperforms other states' lotteries. A competitively bid lease would reverse the anemic trend of current lottery sales, guarantee a steady and growing stream of revenues to education, and provide billions of dollars in additional fiscal benefits to the state's General Fund.
- While the May Revision does not rely on the proceeds from a lottery lease to balance, one potential use of the proceeds from selling a long-term license to operate the lottery would be to pay off $8 billion in outstanding ERBs. This would free up $3.1 billion in both the 2007-08 and 2008-09 budgets which otherwise will be used for debt service.

Summary Charts

This section provides various statewide budget charts and tables.

2007-08 May Revision
General Fund Budget Summary
(Dollars in Millions)

	2006-07	2007-08
Prior Year Balance	$10,540	$3,961
Revenues and Transfers	$95,685	$101,253 [1/]
Total Resources Available	**$106,225**	**$105,214**
Non-Proposition 98 Expenditures	$61,072	$61,836 [1/]
Proposition 98 Expenditures	$41,192	$41,929
Total Expenditures	**$102,264**	**$103,765**
Fund Balance	**$3,961**	**$1,449**
Reserve for Liquidation of Encumbrances	$745	$745
Special Fund for Economic Uncertainties	$3,216	$704
Budget Stabilization Account	**$472**	**$1,495**
Total Available Reserve	**$3,688**	**$2,199**

[1/] A total of $2,046 million will be transferred to the Budget Stabilization Account pursuant to Proposition 58. Half will remain in the Account for future purposes (displayed as a reduction in revenues). The other half will be further transferred for the purpose of early retirement of Economic Recovery Bonds (displayed as an increase in expenditures).

2007-08 Revenue Sources
(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2006-07
Personal Income Tax	$55,236	$1,589	$56,825	$3,160
Sales Tax	28,841	5,757	34,598	1,593
Corporation Tax	11,053	-	11,053	336
Highway Users Taxes	-	3,546	3,546	60
Motor Vehicle Fees	26	5,506	5,532	278
Insurance Tax	2,181	-	2,181	15
Liquor Tax	325	-	325	4
Tobacco Taxes	120	981	1,101	11
Other	3,471	9,425	12,896	1,890
Total	**$101,253**	**$26,804**	**$128,057**	**$7,347**

Note: Numbers may not add due to rounding.

2007-08 Total Expenditures by Agency
(Dollars in Millions)

	General Fund	Special Fund	Bond Funds	Totals
Legislative, Judicial, Executive	$3,864	$2,075	$462	$6,401
State and Consumer Services	576	806	22	1,404
Business, Transportation & Housing	1,650	7,972	3,332	12,954
Resources	1,687	2,086	2,133	5,906
Environmental Protection	90	1,039	467	1,596
Health and Human Services	29,907	8,124	158	38,189
Corrections and Rehabilitation	9,969	22	-	9,991
K-12 Education	41,367	-6	3,990	45,351
Higher Education	11,994	42	3,015	15,051
Labor and Workforce Development	118	304	-	422
General Government	2,543	5,454	602	8,599
Total	**$103,765**	**$27,918**	**$14,181**	**$145,864**

Note: Numbers may not add due to rounding.

General Fund Expenditures by Agency
(Dollars in Millions)

	2006-07	2007-08	Change	%
Legislative, Judicial, Executive	$3,522	$3,864	$342	9.7%
State and Consumer Services	613	576	-37	-6.0%
Business, Transportation & Housing	3,019	1,650	-1,369	-45.3%
Resources	2,096	1,687	-409	-19.5%
Environmental Protection	88	90	2	2.3%
Health and Human Services	29,668	29,907	239	0.8%
Corrections and Rehabilitation	9,385	9,969	584	6.2%
K-12 Education	40,197	41,367	1,170	2.9%
Higher Education	11,441	11,994	553	4.8%
Labor and Workforce Development	108	118	10	9.3%
General Government	2,127	2,543	416	19.6%
Total	**$102,264**	**$103,765**	**$1,501**	**1.5%**

Note: Numbers may not add due to rounding.

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Economic Outlook

The cooling housing sector has continued to slow the national and California economies since the Governor's Budget forecast was constructed in November. A sharp drop in home building was instrumental in the national economy growing at its slowest pace in four years in the first quarter of 2007. In California, housing permits were 40 percent below the peak level reached in the third quarter of 2005. While the downturn in the housing sector will likely last longer than anticipated in the Governor's Budget forecast, encouraging signs are apparent. Home building was less of a drag on the national economy in the first quarter of 2007 than it was in the last two quarters of 2006, and California housing permits have been stable in the last six months. More importantly, there is little evidence that the weakness in the housing sector has spread to other parts of the national and California economies.

The most significant changes in the May Revision forecast are reduced estimates of California housing permits and personal income growth to reflect the faster-than-expected decline in the state's housing sector and its likely effects on personal income. For 2007, permits are projected to be where they averaged in the last six months at an annual rate, before increasing gradually in 2008 and 2009. The forecast for California personal income growth in 2007 has been lowered in the expectation that earnings will grow more slowly for construction workers, realtors, mortgage lenders, and other housing-related workers. Overall job growth in 2007, however, is slightly higher in the May Revision forecast, as other sectors of the state's economy are doing a good job of making up for jobs lost in the housing sector.

The outlook for the national economy is for slower growth in 2007 and improved growth in 2008 and 2009:

- Real GDP is projected to grow 2.2 percent in 2007, 3.1 percent in 2008, and 3.4 percent in 2009, as compared to 3.3 percent in 2006.

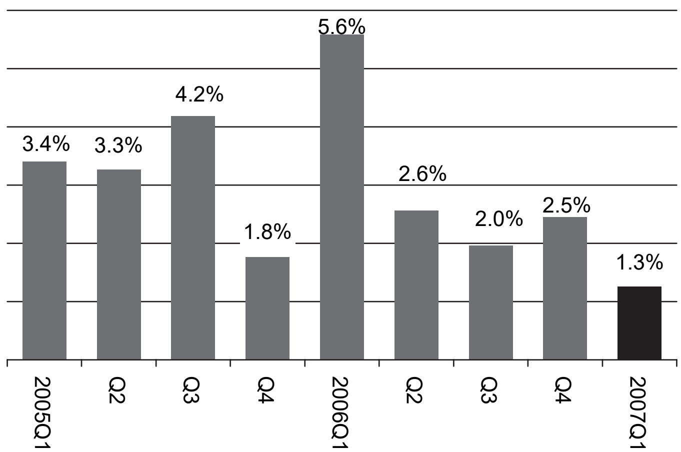
- Nonfarm payroll employment is forecast to increase 1.3 percent in 2007, 1.2 percent in 2008 and 1.6 percent in 2009, as compared to 1.9 percent in 2006.

The outlook for the California economy is also for slower growth in 2007 followed by improved growth in 2008 and 2009:

- Personal income is projected to grow 5.3 percent in 2007, 5.5 percent in 2008, and 5.8 percent in 2009, as compared to 6.1 percent in 2006.
- Nonfarm payroll employment is forecast to increase 1.3 percent in 2007, 1.5 percent in 2008 and 1.8 percent in 2009, as compared to 1.8 percent in 2006.

The Nation

Figure ECO-01
Gross Domestic Product
Change from the Previous Quarter
Annualized Percent



Economic growth slowed considerably from the first quarter of 2006 to the first quarter of 2007 (Figure ECO-01). Recovery efforts after Hurricane Katrina boosted growth in the first quarter of 2006. Even after accounting for that, there remained a significant decline in output growth, much of it due to the downturn in the nation's housing sector. The fall in residential construction alone lopped more than one percentage point off of output growth in the third and fourth quarters of 2006 and one percentage point in the first quarter of 2007. Output of construction-related industries, such as housing finance and real estate brokerage and sales also fell or slowed. Statistics on home sales, housing starts, and residential construction show little evidence that the housing sector downturn is stabilizing. The sector will likely continue to be a major drag on the economy in the second quarter and perhaps the third quarter of 2007. Signs of growing stability should be evident by year-end.

Residential construction was the only major industry with output falling in the last four quarters. Other sectors saw output growth slow, but remain positive. Spending by businesses on equipment and software was surprisingly slow, given the strong profits corporations have enjoyed, the tight capacity in some industries, and the modest amount of this investment businesses have made in this expansion, by historical standards. This spending rebounded in the first quarter and in April after falling sharply in the fourth quarter of 2006. This rebound is expected to continue.

Exports grew strongly in 2006 before falling slightly in the first quarter of 2007. With the dollar falling in value against the Euro and other major currencies, and several major economies likely to grow more strongly than the U.S. economy in 2007, U.S. exports are expected to be strong again in 2007.

Even though economic output grew by less than 2 percent in the first quarter of 2007, consumer spending rose a brisk 3.8 percent. Spending on motor vehicles and parts, medical care, and energy goods and services was particularly healthy. Coming when other sectors of the economy have cooled, this strong performance makes it likely that the first quarter will be the low point of the year.

Job gains slowed in the first four months of 2007, averaging only 129,000 per month. In 2006, the average monthly gain was 189,000. The national unemployment rate has settled at about 4.5 percent. Tight labor markets have resulted in average weekly earnings gains of about 3.5 percent over a year ago.

Energy prices shot up in the first four months of 2007, with the average price for regular-grade gasoline reaching $3 per gallon and crude oil prices pushing $65 per barrel. These increases have boosted broad measures of inflation in the economy. Measures of inflation that exclude energy prices have eased somewhat but remain above the Federal Reserve's desired range of 1 to 2 percent. With economic growth slowing and inflation higher than it likes, the Federal Reserve policy is unlikely to change its policy.

California

California began 2007 with a job loss in January, but February and March brought positive job gains. The annual benchmark revision of employment statistics in March revealed that considerably more jobs were created in the state during 2006 than were initially reported. The state added 275,000 jobs in 2006, the best gain since 2000. Nine out of the 11 major industry sectors saw employment grow in 2006. The state's unemployment rate averaged 4.9 percent in 2006 and was 4.8 percent in each of the first three months of 2007. An important development has been improved job growth in the San Francisco Bay Area. The region had the strongest percentage job growth of major California regional economies in 2006.

California personal income grew by an estimated 6.1 percent in 2006, somewhat stronger than in 2005. Taxable sales slowed considerably, however, in the second half of 2006. For the year as a whole, taxable sales increased 3.9 percent compared to 7.4 percent in 2005. New vehicle registrations fell in 2006 and likely played a role in the slowdown of taxable sales.

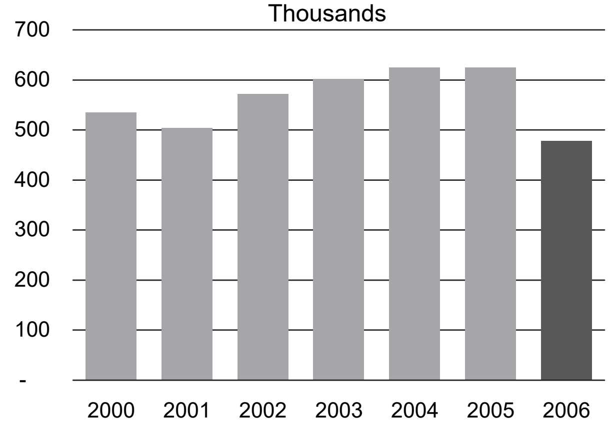
Made-in-California exports grew by 9.4 percent to a new-record level of $127.7 billion in 2006. High-tech exports grew 6.7 percent in 2006. Exports of chemicals, miscellaneous manufactured products, and food and kindred products all grew at double-digit rates. Leading export destinations, in order, were Mexico, Canada, Japan, mainland China, South Korea, Taiwan, the United Kingdom, Hong Kong, Singapore, and Germany. Except for Hong Kong, state exports expanded to all of these markets.

California home building and residential real estate markets slowed considerably in 2006. The number of residential units permitted fell 22 percent, as compared to 15 percent for the nation; however, permits increased in the state in the first quarter of 2007. Existing, single-family detached home sales fell 24 percent in 2006, and home price appreciation slowed considerably (Figure ECO-02).

Figure ECO-02

California Existing, Single-family Detached Home Sales

Thousands



Source: California Association of Realtors

The Forecast

The struggling housing sector will continue to weigh on the state and national economies during the rest of 2007 and, to a lesser extent, in 2008, but economic growth should steadily improve beginning in the third quarter of 2007 (Figure ECO-03 and Figure ECO-04).

Figure ECO-03

Selected U.S. Economic Indicators

	2006 (Est.)	2007 (Projected)	2008 (Projected)
Real gross domestic product, (2000 dollar) (Percent change)	3.3	2.2	3.1
Personal consumption expenditures	3.2	3.2	3.0
Gross private domestic investment	4.3	(4.8)	3.4
Government purchases of goods and services	2.1	2.5	1.7
GDP deflator (2000=100) (Percent change)	2.9	2.3	1.7
GDP, (Current dollar) (Percent change)	6.3	4.6	4.8
Federal funds rate (Percent)	5.0	5.2	5.0
Personal income (Percent change)	6.3	5.5	5.3
Corporate profits before taxes (Percent change)	19.2	3.4	2.8
Nonfarm wage and salary employment (Millions)	136.2	137.9	139.6
(Percent change)	1.9	1.3	1.2
Unemployment rate (Percent)	4.6	4.7	4.7
Housing starts (Millions)	1.8	1.4	1.6
(Percent change)	(12.4)	(21.3)	8.6
New car and light truck sales (Millions)	16.5	16.7	16.9
(Percent change)	(2.6)	1.0	1.5
Consumer price index (1982-84=100)	201.6	205.5	209.7
(Percent change)	3.2	2.0	2.0

Forecast based on data available as of April 2007.
Percent changes calculated from unrounded data.

Figure ECO-04

Selected California Economic Indicators

			Projected			
	2006	Percent change	2007	Percent change	2008	Percent change
Personal income ($ billions)	1,416.6	6.1%	1,491.9	5.3%	1,573.4	5.5%
Nonfarm W&S employment (thousands)	15,064.9	1.8%	15,257.2	1.3%	15,485.1	1.5%
Natural resources and mining	25.1	6.7%	26.5	5.4%	27.0	2.1%
Construction	937.5	3.6%	920.6	-1.8%	921.0	0.0%
Manufacturing	1,502.7	-0.8%	1,497.6	-0.3%	1,501.4	0.3%
High technology	393.0	-0.8%	392.7	-0.1%	395.0	0.6%
Trade, transportation, & utilities	2,870.8	1.7%	2,916.7	1.6%	2,958.5	1.4%
Information	471.8	-0.4%	473.2	0.3%	482.0	1.9%
High technology	205.6	-0.5%	207.8	1.1%	212.2	2.1%
Financial activities	937.8	1.1%	939.5	0.2%	943.0	0.4%
Professional and business services	2,226.6	3.7%	2,292.2	2.9%	2,360.8	3.0%
High technology	285.5	5.2%	299.2	4.8%	313.4	4.7%
Educational and health services	1,618.5	2.0%	1,653.5	2.2%	1,685.5	1.9%
Leisure and hospitality	1,520.0	3.1%	1,555.0	2.3%	1,592.6	2.4%
Other services	506.6	0.2%	512.1	1.1%	521.3	1.8%
Government	2,447.4	1.3%	2,470.4	0.9%	2,491.9	0.9%
Unemployment rate	4.9%		5.0%		5.0%	
Housing permits (thousands of units)	162.9	-22.1%	132.8	-18.5%	143.4	7.9%
Consumer price index (1982-84=100)	210.4	3.9%	216.2	2.8%	221.8	2.6%

Forecast based on data available as of April 2007.
Percent changes calculated from unrounded data.

Revenue Estimates

General Fund revenues are expected to be $95.685 billion in 2006-07 and $101.253 billion in 2007-08. This represents an increase of $1.166 billion in 2006-07 and a reduction of $24 million compared to the Governor's January budget. These totals reflect transfers to the Budget Stabilization Account of $472 million in 2006-07 and $1.023 billion in 2007-08. Figure REV-01 displays the forecast changes between Governor's Budget and May Revision.

Personal Income Tax

The personal income tax forecast has been increased by $201 million in 2006-07 and decreased by $362 million in 2007-08. Through April, General Fund personal income tax receipts were $309 million, or 0.7 percent, below the forecast in the Governor's January budget. Refunds in May and June are now expected to be lower than estimated in December, offsetting higher refunds earlier in the tax-filing season.

2005 tax data, the most recent information available, showed higher income and liability growth for taxpayers with adjusted gross income over $200,000 than for those with income under $200,000. The forecast assumes that this growth difference continued in 2006. Capital gains income grew 48 percent in 2005. This forecast estimates that capital gains income will grow 10 percent in 2006 and 2 percent in 2007.

Figure REV-01

General Fund Revenue Forecast
Reconciliation with the 2007-08 Governor's Budget
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change Between Forecasts	
Fiscal 05-06				
Personal Income Tax	$49,877	$49,901	$24	0.0%
Sales & Use Tax	27,581	27,581	$0	0.0%
Corporation Tax	10,316	10,316	$0	0.0%
Insurance Tax	2,202	2,202	$0	0.0%
Alcoholic Beverage	318	318	$0	0.0%
Cigarette	118	118	$0	0.0%
Other Revenues	3,022	3,022	$0	0.0%
Transfers	-7	-7	$0	0.0%
Total	**$93,427**	**$93,451**	**$24**	**0.0%**
Fiscal 06-07				
Personal Income Tax	$52,042	$52,243	$201	0.4%
Sales & Use Tax	27,775	27,787	$12	0.0%
Corporation Tax	10,311	10,717	$406	3.9%
Insurance Tax	2,220	2,166	-$54	-2.4%
Alcoholic Beverage	321	321	$0	0.0%
Cigarette	121	119	-$2	-1.7%
Other Revenues	2,371	2,368	-$3	-0.1%
Transfers	-642	-36	$606	-94.4%
Total	**$94,519**	**$95,685**	**$1,166**	**1.2%**
Change from Fiscal 05-06	$1,092	$2,234		
% Change from Fiscal 05-06	1.2%	2.4%		
Fiscal 07-08				
Personal Income Tax	$55,598	$55,236	-$362	-0.7%
Sales & Use Tax	29,347	28,841	-$506	-1.7%
Corporation Tax	10,816	11,053	$237	2.2%
Insurance Tax	2,354	2,181	-$173	-7.3%
Alcoholic Beverage	325	325	$0	0.0%
Cigarette	122	120	-$2	-1.6%
Other Revenues	3,101	3,772	$671	21.6%
Transfers	-386	-275	$111	-28.8%
Total	**$101,277**	**$101,253**	**-$24**	**0.0%**
Change from Fiscal 06-07	$6,758	$5,568		
% Change from Fiscal 06-07	7.1%	5.8%		
Three-Year Total			$1,166	

These figures reflect reductions to revenues for transfers of $472 million in 2006-07 and $1.023 billion in 2007-08 to the Budget Stabilization Account

Sales and Use Tax

The sales and use tax forecast has been increased by $12 million in the current year and decreased by $506 million in the budget year. Through March, sales tax receipts have tracked closely to estimates.

Current law requires the transfer of some gasoline and diesel fuel sales tax revenues from the General Fund to the Public Transportation Account (PTA); a portion of this transfer is known as "spillover." In 2006-07, $200 million of spillover revenues that would otherwise be transferred to the PTA was used to repay transportation debt and $125 million was transferred to the Bay Area Toll Account. The Governor's Budget estimated that $224 million would be transferred to the PTA as spillover in 2006-07; this amount has been increased to $226 million.

The Governor's January budget estimated $617 million in spillover funds for 2007-08 and proposed that $340 million be used to repay transportation debt, with the remainder transferred to the PTA as spillover. The May Revision forecasts that 2007-08 spillover transfers will be $827 million due to higher gas prices in 2007.

Corporation Tax

Stronger corporate profits increased the corporation tax forecast by $406 million for 2006-07 and $237 million for 2007-08.

Insurance Tax

Higher estimated refunds reduced the insurance tax forecast by $54 million in 2006-07. Revenues for 2007-08 are reduced by $173 million to reflect the initial impact of a recent Board of Equalization ruling that the gross premiums tax insurers pay be calculated on a cash basis, rather than the accrual method used by the Department of Insurance.

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Demographic Information

Population

California's population is expected to reach 37,870,000 on July 1, 2007 and over the budget year is expected to increase by 456,000 residents to reach 38,326,000 on July 1, 2008. This growth of nearly half a million Californians will be made up of 315,000 more births than deaths and 141,000 more people moving to California from other states and nations than are leaving California. Because both components of population change have slowed, the July 1, 2008 population projection is one-tenth of one percent, or 44,000 lower than projected in the Governor's Budget. These estimates are used in projecting the State Appropriations Limit, the Proposition 98 growth factor, and are reflected in many caseload estimates.

Average Daily Attendance

Average Daily Attendance (ADA) in school districts, including summer school, is expected to drop from 6,203,294 in school year 2006-07 to 5,993,301 in school year 2007-08. ADA is up two-tenths of one percent from the projection in the Governor's Budget. This slight upward revision was caused by offsetting trends in enrollment and attendance. Although enrollment was slightly lower than projected in the Governor's Budget, attendance reported in the beginning of the school year came in slightly higher than projected. ADA for Proposition 98 purposes includes students served by county offices of education but excludes summer school and is reported in the Education section.

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Legislative, Judicial, and Executive

Governmental bodies classified under the Legislative, Judicial, and Executive section of the Governor's Budget are either independent entities under the California Constitution or departments with a recognized need to operate outside of the administrative oversight and control of an agency secretary. Constitutionally established bodies include the Legislature, Judicial Branch, Governor's Office, and Constitutional Officers. This section also includes such independent entities as the Inspector General, the Office of Emergency Services, the Office of Homeland Security, and the California State Lottery.

Judicial Branch

The May Revision includes an increase of $36.6 million General Fund for Trial Court security needs based on the recommendations of the Court Security Working Group. This proposal reflects a comprehensive court security funding plan agreed upon by the Administrative Office of the Courts (AOC) and sheriffs to address court security issues. This increase will provide funding for security personnel to stand guard in courtrooms, monitor screening stations, and transport prisoners within court facilities. Finally, the May Revision proposes to establish a separate appropriation in the budget for court security and to adopt related cost-containment policies recommended by sheriffs and the AOC.

Office of Homeland Security

The May Revision proposes $177.6 million transportation bond funds, as approved by Proposition 1B, to establish two homeland security grant programs:

- $76.1 million for the Port Security Grant Program to be allocated to various ports in California to purchase security equipment in order to prevent and respond to acts of terrorism.

- $101.5 million for the Transit Security Grant Program to be allocated to various mass transit systems to purchase security equipment, lighting, and other security improvements in order to prevent and respond to acts of terrorism.

Office of Emergency Services

The May Revision proposes $7.4 million General Fund and $8.9 million other funds for various programs for the Office of Emergency Services (OES), which include:

- $4.9 million in federal funds to establish four new federal anti-gang grants as part of a six-city gang suppression effort.
- $4 million Restitution Fund to augment four Internet Crimes Against Children Task Forces, one each in Sacramento, San Jose, San Diego, and Los Angeles. This funding will enhance the investigative response to offenders who use the internet to sexually exploit children.
- $446,000 General Fund to establish and support a State Anti-Gang Coordinator position in the OES. This position will coordinate anti-gang programs at all state agencies, track all federal anti-gang funding and grants, and collect, evaluate, and promote anti-gang effort best practices.
- $7 million General Fund for local anti-gang programs. The Coordinator will administer this grant program and allocate funding to eligible local governments on a competitive basis to be used for local anti-gang suppression, intervention, and prevention programs.

Proposed Anti-Gang Program Funding Source

The May Revision proposes funding various anti-gang programs by increasing the state surcharge levied on the base fine used to calculate the state penalty assessment from 20 percent to 40 percent. In addition, it is proposed that the responsibility of collecting fines, fees, and penalties transfers from the counties to the courts to increase collection efficiencies and consistency.

Tribal Gaming Revenues

The May Revision includes a revised General Fund revenue projection of $313.5 million in 2007-08 from the ratification and implementation of five amended Tribal Gaming Compacts, which is $192.4 million less than the estimate included in the Governor's Budget.

California Gambling Control Commission

The May Revision proposes $1.7 million Indian Gaming Special Distribution Fund and 14 positions to establish an audit and compliance unit to review and enforce the minimum internal control standards adopted by gaming tribes pursuant to the terms of their respective gaming compacts. These standards govern the way each tribe will conduct its business on a day-to-day basis and seek to ensure fair play for gaming patrons.

Department of Justice

The May Revision includes an increase of $11.2 million General Fund and a corresponding decrease of $11.2 million DNA Identification Fund to reflect a revised estimate of penalty assessment revenues. This funding will be used to collect DNA samples pursuant to the provisions of Proposition 69, the DNA Fingerprint, Unsolved Crime and Innocence Protection Act. This funding is essential to maintain the Department of Justice's (DOJ) ability to process DNA samples for inclusion in the DNA Databank, as required by law.

The May Revision also includes an increase of $3 million Restitution Fund to increase support for the California Witness Protection Program. This adjustment will allow the DOJ to better support district attorneys in their effort to protect witnesses and their families who are endangered because of ongoing or expected testimony.

Secretary of State

The May Revision proposes $11.7 million General Fund for the Secretary of State to conduct the February 2008 Presidential Primary Election authorized by Chapter 2, Statutes of 2007 (SB 113). The funds are for various activities required for the election, including state ballot preparation and printing, voter registration, voter participation, the voting process, and election night reporting.

Consistent with the intent of SB 113, the state will reimburse counties for their costs associated with the Presidential Primary Election. Since county claims for reimbursement will likely not be available until mid-May of 2008, the Administration intends to address the county costs in the 2008-09 Budget.

Office of the Inspector General

The May Revision includes an increase of $810,000 General Fund to support the California Rehabilitation Oversight Board (C-ROB) established by AB 900 (Chapter 7, Statutes of 2007). The C-ROB, chaired by the Inspector General, is tasked with examining the various mental health, substance abuse, educational and employment programs for inmates and parolees operated by the California Department of Corrections and Rehabilitation.

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Business, Transportation, and Housing

The Business, Transportation and Housing Agency oversees programs that promote the state's business and economic climate, transportation infrastructure, affordable housing, and patient rights. The Agency also promotes public safety through the California Highway Patrol and the Department of Alcoholic Beverage Control. The majority of funding is derived from special fund revenues, federal funds, and the proceeds from Proposition 1B, the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006.

Transportation Bond Funding

The Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 authorizes $19.925 billion over the next 10 years to fund existing and new statewide transportation-related infrastructure programs and projects. The Governor's Budget proposed $7.685 billion for allocation to various programs and projects over three years and language to provide flexibility to ensure that those projects that are ready to commence be funded as soon as possible. The May Revision continues this proposal and updates the proposed appropriations in the Budget Bill to $11.5 billion over three years.

The Governor's Budget also anticipated a need to appropriate bond funds in 2006-07 for projects that were ready-to-go. Because Caltrans has been able to identify project savings to accelerate over $331 million for State Transportation Improvement Program and State Highway Operations and Protection Program projects in 2006-07, more money is available for other projects to be funded from the bonds.

Bond Program Funding Changes

Figure BTH-01 reflects changes in estimated needs for appropriations in the Proposition 1B bond programs. Major changes since January include an acceleration in funding for the Corridor Mobility and Highway 99 programs consistent with the California Transportation Commission's actions to approve projects, and additional funding for State Transportation Improvement Program projects and retrofitting school buses. The May Revision also proposes $187 million in 2007-08 for the purchase of rail cars and locomotives, provided that the audit of Caltrans' rail equipment needs currently being conducted by the Office of State Audits and Evaluations identifies a need to purchase in 2007-08, and new funding proposals for security at ports and harbors and air quality improvement.

Figure BTH-01
Planned Proposition 1B Implementation
(Dollars in Millions)

	Budget Bill Appropriations			
	2007-08	**2008-09**	**2009-10**	**Total Three-year Appropriations**
Corridor Mobility	$610	$1,577	$1,229	$3,416
Transit	$600	$350	$350	$1,300
State Transportation Improvement Program	$739	$799	$274	$1,812
Local Streets and Roads	$600	$300	$150	$1,050
Trade Infrastructure	$202	$302	$302	$806
State Highway Operation and Protection Program	$405	$267	$24	$696
State/Local Partnership	$202	$197	$200	$599
Grade Separations	$123	$123		$246
Highway 99	$16	$109	$302	$427
School Bus Retrofit	$97	$97		$194
Local Seismic	$14	$11	$11	$36
Air Quality Improvement	$111			$111
Port, Harbor, and Ferry Terminal Security	$178	$123	$101	$402
Intercity Rail	$190	$74	$128	$392
Total Appropriations	$4,087	$4,329	$3,071	$11,487

Department of Transportation

- 2006-07 -$8.6 million General Fund; $8.6 million Other Funds
- 2007-08 $5.4 million General Fund; $1,098 million Other Funds (Primarily Proposition 1B)

Capital Outlay Support Staffing

The Department traditionally submits a zero-based Capital Outlay Support request as part of the May Revision based on anticipated project allocations by the California Transportation Commission for the upcoming year and the resources needed to proceed with those projects. The May Revision projects 2007-08 capital outlay support and bond-related workload increases totaling $206 million and 527 personnel years, with slightly higher levels through 2010 and declining significantly thereafter. This staffing proposal reflects 85 percent state staff and 15 percent contract staff for all capital outlay support and bond-related activities. Nonbond-related workload is declining slightly and 100 vacant state positions have been reduced, reflecting a lower level of ongoing workload. The May Revision includes $129 million for contract positions to complete bond-related workload, representing approximately 95 percent of the total bond-related workload. The proposal also includes sufficient funding for existing positions that are expected to be filled by the end of 2006-07, with the balance of peak workload to be performed by contract staff. This will facilitate the rapid delivery of bond-funded projects and avoid the need in the future to significantly reduce the staffing level.

The May Revision also proposes 112 positions and $13.4 million for administrative costs directly related to the expenditure of bond funds for Proposition 1B programs, including budgeting, accounting, planning, programming, and auditing. The ongoing need for administration resources will be evaluated annually as part of the budget development process as bond expenditures are further determined.

Public Transportation Account

A portion of the revenue in the Public Transportation Account (PTA) is derived from "spillover" sales tax on gasoline. The revenues occur when revenue derived from gasoline sales taxes is proportionately higher to revenue derived from all taxable sales pursuant to a statutory formula, and generally reflect higher gas prices. The Governor's Budget projected $617 million in spillover revenues for 2007-08 and proposed to reallocate those funds, along with other funding available in the PTA, to offset General Fund expenditures for K-12 home-to-school transportation, debt service on transportation related General Obligation bonds, and transportation services for regional development centers.

In April, a Finance Letter was proposed to establish Budget Bill Control Section 24.8 to amend the way in which home-to-school transportation funding and General Fund savings would be achieved.

May Revision revenue estimates increase the amount of spillover funding available by $210 million in 2007-08. Of this amount, the May Revision proposes to amend Control Section 24.8 to reimburse the General Fund for $200 million in 2006-07 home-to-school transportation expenditures. (See the Education chapter.) Additional revenues from spillover of $5 million in 2006-07 and $28 million from sales tax on diesel fuel in 2007-08 provide funding for an increase in state transit assistance grants from $185 million to $206 million in 2007-08. It is projected that these grants will grow to $373 million in 2008-09.

Spillover revenues are projected to grow to $935 million in 2008-09. While such estimates are highly uncertain, there appears to be sufficient fiscal capacity in the Account to continue to offset an additional $200 million in General Fund costs in 2008-09 and ongoing, while providing at least $100 million for program growth in the PTA.

Department of Motor Vehicles

- 2006-07 No Change
- 2007-08 $9.4 million

Implementation of Vehicle Registration Financial Responsibility Program

The May Revision proposes funding for vendor costs to reflect higher than anticipated activity in this program. The program was established by Chapter 920, Statutes of 2004 (SB 1500) and requires insurance companies to electronically report insurance policies on private-use vehicles and the suspension of vehicle registrations when evidence of insurance is not provided within specified timelines. Suspension notices are expected to be sent for 5.5 million vehicles lacking proof of insurance rather than the 3.6 million anticipated in the Governor's Budget. The Department of Motor Vehicles will work with the industry to reduce error rates and address program anomalies, which will reduce future costs.

Motor Vehicle Account

The Administration recognizes that the balance for the Motor Vehicle Account is rapidly declining, but the fund will be sufficient to fully fund 2007-08 proposed expenditures. A working group of affected agencies will continue to look at cost trends and future program needs, savings measures, and funding options including potential new funding sources to ensure the solvency of the fund. The working group will provide recommendations for consideration in the 2008-09 Governor's Budget.

Environmental Protection

The May Revision proposes to begin expenditures of the $1 billion made available by Proposition 1B for air quality improvement projects along the state's main highway and trade corridors. In addition, the May Revision proposes additional resources for the California Air Resources Board to ensure adequate oversight of grant funding under the Carl Moyer Incentive Program.

- 2006-07 No Change
- 2007-08 $111 million

Proposition 1B Air Quality Investments

The Air Resources Board proposes to spend $111 million in Proposition 1B bond funds to implement its Trade Corridors Emission Reduction Incentive Program. Under the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, the Air Resources Board is authorized to spend a total of $1 billion on projects to improve the air quality in California's major trade corridors. These corridors include the Los Angeles/Inland Empire Region, the Central Valley, the Bay Area, and the San Diego/Border Region.

Projects expected to be funded by the Air Resources Board include the following:

- upgrade of old, high-emitting trucks used to serve ports and intermodal rail yards, and to transport goods and farm produce throughout the state;
- electrification of piers that serve frequent visitor ships to avoid the use of onboard diesel generators;

- replacement of older switch engines and other locomotives with new models meeting ultra-low emissions levels; and
- replacement of existing diesel engines on harbor craft with new, cleaner engines.

In administering the program, the Air Resources Board will give priority to projects that provide the greatest lifetime emissions reduction in each corridor for each state dollar invested. Using this criterion provides an incentive for projects that offer substantial matching funds and are long-lived without prohibiting the Air Resources Board from funding projects that produce dramatic emissons reductions regardless of match amount or project life.

Carl Moyer Program Accountability

The Air Resources Board proposes to add 6.0 permanent positions, and to re-establish 2.0 expiring positions, to continue and expand oversight and accountability of the Carl Moyer Air Quality Incentive Program. Chapter 627, Statutes of 2006, authorized an increase in the portion of Carl Moyer funds that may be used for administration. In response to this change, the Air Resources Board will redirect $900,000 to fund the present request. These positions will be used both for program oversight and to assist key underperforming districts in improving local administration of the program.

Health and Human Services

The May Revision maintains a strong and responsible safety net for California's most vulnerable residents, continues the reform proposals and initiatives included in the Governor's Budget, and increases investments in targeted areas to improve the health and safety of Californians. In doing so, the May Revision strikes a reasonable and responsible balance between the need to provide essential services while managing and controlling program growth and costs.

May Revision Adjustments-Highlights

New Rate Methodology for Medi-Cal Managed Health Care Plans

After an extensive effort, recommendations have been made by an independent consultant to improve the Department of Health Services' (DHS') rate-setting methodology for Medi-Cal managed health care plans. These plans play a crucial role in providing access to health care for vulnerable Californians, serving approximately 3.2 million Medi-Cal beneficiaries each year. The May Revision includes $214.3 million ($107.1 million General Fund) to provide rate adjustments to the plans as determined by the new rate methodology, which will be implemented at the beginning of each plan's new rate year. This funding will provide a transition period to plans that otherwise would have received rate reductions under the new methodology. This is consistent with the state's prior practice of phasing in rate adjustments. Supporting a stable Medi-Cal managed care network is important to ensure adequate access to care and to support the successful implementation of Health Care Reform.

Salary Increases for Classifications Affected by the Coleman and Perez Court Cases

The May Revision includes total funding of $1.6 million ($914,000 General Fund) for the Department of Developmental Services and $7.5 million ($7.4 million General Fund) for the Department of Mental Health to provide salary increases to employees in job classifications affected by these court cases. These increases are necessary to properly protect and serve the clients of these departments by retaining existing staff and enhancing the recruitment of additional mental health and dental professionals. This funding will enable the departments to increase salaries for psychiatrists and senior psychologists by between 66 and 74 percent, and raise salaries for all other impacted mental health classifications by between 10 and 40 percent. This funding also will increase salaries for both departments' dental staff by between 36 and 58 percent.

Early and Periodic Screening, Diagnosis and Treatment Program

The Early and Periodic Screening, Diagnosis and Treatment Program (EPSDT) program provides physical and mental health services to full-scope Medi-Cal beneficiaries under the age of 21. The May Revision proposes a decrease of $24.3 million ($12.2 million General Fund and $12.1 million in federal fund reimbursements) due to a lower estimate of EPSDT claims than included in the Governor's Budget. The May Revision includes an increase of $39.9 million ($17.2 million General Fund and $22.7 million in federal fund reimbursements) to pay for the settlement of audits from the 2004-05 fiscal year, consistent with historical practice.

Responding to program and fiscal concerns, including a 2006-07 deficiency request for $243 million to pay prior year obligations owed to counties, the Department of Finance's Office of State Audits and Evaluations (OSAE) recommended the elimination of the cost settlement adjustment, historically used to discount claims estimates. The OSAE found that continuing to use the discount factor could result in under-funding and contribute to future deficiency requests. The May Revision reflects an increase of $61.6 million ($30.8 million General Fund and $30.8 million in federal fund reimbursements) for 2007-08, and will minimize the future accumulation of obligations for each fiscal year going forward.

Emergency Funding for Food Banks

The May Revision continues the Administration's unprecedented commitment to provide state funding, in response to last winter's freeze disaster, to local food banks and the California Emergency Foodlink, a private organization that stores and delivers food during emergencies. A total of $4.7 million General Fund already has been allocated pursuant to Government Code

Section 8690.6, and the May Revision proposes an additional $4.45 million General Fund for food banks and the Foodlink.

Federal aid recently was made available to provide disaster unemployment insurance and commodities for individuals affected by the freeze. The federal commodities began arriving in April 2007. The emergency funding provided by the state has been used for the purchase and distribution of food to affected individuals, and to replenish and increase the state's reserve to prepare for future emergency distributions. In addition, the funding included in the May Revision will enable the food banks to store and distribute food from the more than 1,500 expected truckloads of federal commodities.

Cost of Doing Business Adjustments for Counties Administering State Social Services Programs

The May Revision proposes a new methodology for adjusting county administrative costs for human services programs. Chapter 75, Statutes of 2006 (AB 1808) required the Department of Social Services (DSS) to estimate the costs for county administration of human services programs using county-specific cost factors, examine factors contributing to those costs, and include the estimated county administration costs in budget documents beginning with the 2007-08 May Revision. AB 1808 also required the DSS to submit a plan to the Legislature for developing a new method of budgeting child welfare services. The Administration proposes a budgeting methodology that would provide predictable, stable funding for county administration costs in the CalWORKs, Food Stamp, Child Welfare Services, Foster Care, Adoptions, In-Home Supportive Services (IHSS), and Adult Protective Services programs, coupled with reforms designed to improve performance and accountability. Specifically, beginning in 2008-09, an annual adjustment to county administration funding would be provided equivalent to the salary and benefit increases provided to state employees, subject to appropriation. Annual adjustments would be coupled with an increased focus on accountability and incentives for improved services for children, families and low-income aged, blind or disabled Californians. The proposed methodology will build on the CalWORKs Pay-for-Performance program, existing state and county sharing in federal penalties for failure to meet performance measures in the CalWORKs and Food Stamp programs, and on the Child Welfare Services Outcomes and Accountability System. Further, the Administration proposes to establish a county share in federal Child Welfare Services penalties and to establish performance and accountability measures for the IHSS program. These reforms will provide a stable funding base for county administration and services that will grow commensurate with personnel costs, as well as introduce fiscal incentives to meet program goals and ensure the efficient use of state funds.

Department of Alcohol and Drug Programs

- 2006-07 $2.3 million
- 2007-08 $8.6 million

Current Year

The May Revision includes an increase of $4.4 million ($2.3 million General Fund), or 0.6 percent, above the $674.3 million provided in the Governor's Budget. This increase is due to revised estimates for caseload and units of service and is added to the pending request for a supplemental appropriation.

- Regular Drug Medi-Cal—Expenditures are expected to be $2.1 million General Fund higher than projected in the Governor's Budget. Caseload is estimated to be 8,370 clients, or 4.7 percent, higher than previously projected.
- Perinatal Drug Medi-Cal—Expenditures are expected to be $283,000 General Fund higher than projected in the Governor's Budget. Caseload is estimated to be 316 clients, or 3.5 percent, higher than previously projected.

Budget Year

The May Revision includes an increase of $17.2 million ($8.6 million General Fund), or 2.6 percent, above the $662.8 million provided in the Governor's Budget, reflecting the following major adjustments:

- Regular Drug Medi-Cal—Expenditures are projected to increase by a total of $8.0 million General Fund. Caseload is projected to increase by 11,876, or 6.3 percent, and the May Revision includes a total of $7.4 million General Fund for provider rate increases (an increase of $5.3 million above the $2.1 million in rate increases proposed in the Governor's Budget).
- Perinatal Drug Medi-Cal—Expenditures are projected to increase by $620,000 General Fund. Caseload is projected to increase by 535, or 5.6 percent, and the May Revision includes $603,000 General Fund for provider rate increases (an increase of $30,000 above the $573,000 in rate increases proposed in the Governor's Budget).
- Proposition 36—The 2006 Budget Act reauthorized $120 million in funding for Proposition 36 and included reforms sought by the Administration to improve the program. Implementation of these reforms has been suspended by judicial injunction. The Budget Act also authorized $25 million for the Substance Abuse Offender Treatment Program (OTP), intended to enhance treatment services.

In response to suspended reforms, the 2007-08 Governor's Budget proposed to reduce Proposition 36 funding by $60 million, and utilize this funding in the OTP. The Governor's Budget also indicated that the Administration would revise the budget proposal at the May Revision to transfer all funding from Proposition 36 to the OTP if the reforms were not implemented. In light of the recent legislation regarding prison rehabilitation programs, the Administration will not propose to transfer all Proposition 36 funding to the OTP. However, the Administration continues to support its proposal to transfer $60 million from Proposition 36 to the OTP, which includes many of the necessary reforms.

Department of Health Care Services

- 2006-07 -$31.0 million
- 2007-08 $87.2 million

Medi-Cal

Current Year

The May Revision reflects total Medi-Cal expenditures of $35.4 billion ($13.6 billion General Fund), a decrease of $85.8 million ($20.7 million General Fund) from the Governor's Budget. General Fund expenditures for Medi-Cal have increased by $797.5 million, or 6.2 percent over the 2005-06 level.

The average monthly Medi-Cal caseload is expected to decrease by 59,500 beneficiaries, to 6,534,600 eligibles, which is a decrease of 0.9 percent from the level projected in the Governor's Budget. The revised caseload is 0.6 percent lower than the 2005-06 caseload.

The net General Fund decrease from the Governor's Budget level includes the following significant adjustments:

- $92 million increase to repay the federal government for non-institutional provider over-payments discovered when recording paid claims that had been audited and identified as erroneous due to miscoding of services, claiming errors, or provider errors.
- $30.5 million increase resulting from a continued delay in federal approval of the State Plan Amendment (SPA) allowing the separation of physician and non-physician costs from certified eligible expenditures under the Hospital Financing Waiver. Approval of the SPA was anticipated in 2006. This would have shifted funding for designated public

hospitals to 100 percent federal funding and provided a corresponding recoupment of state funds in the current year. Recoupment is now anticipated in 2007-08.

- $63.5 million decrease resulting from the Medi-Cal dental fiscal intermediary's repayment of premium costs that exceeded audited expenditures, which were much lower than anticipated due to statutory restrictions on covered benefits and more stringent authorization requirements.
- $51.9 million decrease in anticipated capitation payments to County Organized Health Systems due to identification of persons dually eligible for Medi-Cal and Medicare and the impact of federal Medicare Part D Pharmacy benefits. When persons are dually eligible, Medi-Cal pays only for services not covered under Medicare.
- $27.1 million decrease in the amount previously estimated to be repaid to the federal government for the federal share of non-emergency services provided to qualified aliens who have been in the country for less than five years, based upon revised data.
- $21.7 million decrease in county and other administration costs due to lower caseload growth, the final reconciliation of county administrative costs for 2004-05, and a delay in county billing for outreach costs.

Budget Year

The May Revision includes total Medi-Cal expenditures of $37.7 billion ($14.7 billion General Fund), a net total funds increase of $330.3 million ($39.4 million General Fund) from the Governor’s Budget. General Fund expenditures are expected to increase by $1.1 billion, or 7.6 percent over the revised 2006-07 level.

The average monthly Medi-Cal caseload is expected to decrease from the Governor’s Budget by 98,600 beneficiaries, or 1.5 percent, to 6,602,900 eligibles.

The net General Fund increase from the Governor’s Budget level includes the following significant adjustments:

- $107.1 million increase for implementation of new rates for all Medi-Cal managed care plans based on the plan-specific, experience-based rate methodology developed as a result of a recent study.
- $39.4 million increase in county and other administration costs due to an update of base costs and funding for the one-time and ongoing costs for implementation of federal Deficit Reduction Act (DRA) citizenship verification requirements.

- $20.0 million increase in the Medi-Cal Minor Consent program due to loss of federal financial participation for a portion of the program. To protect the ability of minors to access pregnancy services, the state will not enforce DRA citizenship and identification requirements for minors independently seeking services.
- $34.2 million decrease in the amount previously budgeted to be repaid to the federal government for the federal share of non-emergency services provided to qualified aliens who have been in the country for less than five years, based upon revised data.
- $30.5 million decrease for anticipated repayments from designated public hospitals that were expected in 2006-07 but are now delayed until early 2007-08 when the State Plan Amendment is expected to be approved.
- $26.1 million decrease in anticipated capitation payments to County Organized Health Systems mainly due to identification of persons dually eligible for Medi-Cal and Medicare and the impact of federal Medicare Part D Pharmacy benefits. When persons are dually eligible, Medi-Cal pays only for services not covered under Medicare.
- $10.6 million decrease in the Medically Indigent Adult Long-Term Care program resulting from a $10.6 million increase in federal funds through the Safety Net Care Pool portion of the hospital financing waiver. This fund shift will allow the state to maximize available federal funding for public hospitals as authorized under the hospital financing waiver.

Family Health Estimates

Current Year

The Family Health May Revision Estimates include a net decrease of $7.8 million ($2.8 million General Fund) from the $262.6 million provided in the Governor's Budget due to minor caseload adjustments in the California Children's Services (CCS) and Child Health and Disability Prevention (CHDP) programs, and the collection of $3.5 million in blood factor rebates in the Genetically Handicapped Persons Program (GHPP).

Budget Year

The May Revision includes a net decrease of $3.0 million (an increase of $50.4 million General Fund and a decrease of $53.4 million other funds), from the $290.0 million provided in the Governor's Budget, due to adjustments in caseload and health care costs in the CCS, CHDP, and GHPP programs. General Fund expenditures will increase in the CCS and GHPP programs by $46.8 million to reflect a proposed redirection in federal Safety Net Care Pool funding. However, the Medi-Cal budget reflects a corresponding General Fund offset that will allow the state to maximize available federal funding for public hospitals as authorized under the hospital financing waiver.

Department of Public Health

- 2007-08 -$9.3 million

Pursuant to Chapter 241, Statutes of 2006 (SB 162), the new Department of Public Health will become operational on July 1, 2007. Funding adjustments for 2006-07 included in the May Revision are reflected in the Department of Health Care Services' totals.

AIDS Drug Assistance Program

The May Revision includes $288.9 million to fully fund the AIDS Drug Assistance Program (ADAP), which is 3.5 percent below the $299.4 million identified in the Governor's Budget. The ADAP will serve nearly 32,905 clients in 2007-08, approximately 1,400 clients above prior fiscal year caseload estimates. These savings are a result of ongoing efforts to realize program efficiencies including benefits coordination with other third party payers, an efficient rebate collection system, and savings related to Medicare Part D, while maintaining existing program caseload and services.

As a result of additional drug rebate revenues, the May Revision reflects one-time General Fund savings of $9.3 million and a one-time redirection of $7.8 million General Fund to other HIV care and treatment programs. The one-time redirection of General Fund will better meet the needs of persons living with HIV and ensure the state maintains compliance with federal maintenance-of-effort requirements and continues to receive federal Ryan White Care Act funds totaling approximately $122.0 million in 2007-08. The May Revision includes redirected funding for the following programs:

- $4.0 million for the Therapeutic Monitoring Program to provide more than 33,000 viral load and resistance tests to approximately 17,000 clients.
- Up to $1.8 million to backfill the expected loss of federal funds to six Eligible Metropolitan Areas.
- $1.5 million for the AIDS Regional Information and Evaluation System, a web-based case management system that supports client access to care and treatment.
- $500,000 to support the development and delivery of capacity building activities.

Cigarette and Tobacco Products Surtax Fund-Proposition 99

The May Revision projects decreased Proposition 99 revenue of $6.0 million in 2006-07, and $6.0 million in 2007-08, for revised total revenues of $333.0 million and $337.0 million in the current year and budget year, respectively. The projected decrease in Proposition 99 revenue is attributable to the General Fund portion of tobacco tax cash receipts being slightly below earlier forecasts, lower-than-expected taxable sales of cigarettes during 2005-06, and a modest downward adjustment to the 18 to 64 age-group population data.

The May Revision continues to maintain the Proposition 99 expenditures proposed in the Governor's Budget for all programs within the Department of Health Care Services and the Department of Public Health. However, due to the decline in projected revenues, the May Revision backfills $8.3 million Proposition 99 for the Access for Infants and Mothers (AIM) program within the Managed Risk Medical Insurance Board with General Fund.

Managed Risk Medical Insurance Board

- 2006-07 $2.5 million
- 2007-08 $16.5 million

Healthy Families Program

Current Year

The Healthy Families Program (HFP) is expected to serve a total of 844,283 children by June 30, 2007, an increase of 73,128, or 9.5 percent, from June 30, 2006. The May Revision projects an overall expenditure increase of $1.3 million ($2.5 million General Fund, -$1.2 million other funds), to $1.0 billion ($362.2 million General Fund), from the level anticipated in the Governor's Budget. This primarily is due to an additional caseload of 2,600 children. Other funds are down by $1.2 million due largely to a delay in starting the web-based Health-e-App project. The design and development phase of this project is anticipated to be completed in late 2007, with the roll-out occurring in the spring of 2008. These costs are therefore shifted to 2007-08.

The state has been notified by the federal government that the HFP to Medi-Cal Bridge (Bridge) program will no longer qualify for federal financial participation. The Bridge provides children with two additional months of HFP coverage when HFP has determined that a child's household income is below HFP eligibility requirements at annual eligibility review. Approximately 2,000 new children per month receive coverage through the Bridge.

The May Revision proposes to continue the Bridge as a state-only program at a cost of $1.5 million General Fund in the current year.

Budget Year

The May Revision projects an overall expenditure increase of $23.8 million ($8.2 million General Fund), to $1.1 billion ($400.4 million General Fund), from the level anticipated in the Governor's Budget. The increase in General Fund is primarily due to a 3.1-percent increase in the average monthly capitation payment for health, dental and vision services.

Between June 2007 and June 2008, enrollment in HFP is projected to grow from 844,283 children to 919,516 children, an 8.9 percent increase. Projected caseload as of the May Revision reflects updates to the impact of various proposals included in the Governor's Budget that promote and maximize enrollment in HFP, improve the retention of children already enrolled, and support county-based efforts to enroll eligible children.

The May Revision proposes to convert the Bridge Program to a Medi-Cal presumptive eligibility program starting on July 1, 2007. The state will receive 50 percent federal participation by converting to presumptive eligibility rather than 100 percent General Fund costs as a state-only program.

Access for Infants and Mothers Program

Current Year

The May Revision projects an overall expenditure decrease of $3.1 million in federal funds from the level anticipated in the Governor's Budget, to $124.4 million. This 2.4-percent decrease in total funds primarily is due to federal fund changes resulting from corrections to the way that subscriber contributions are budgeted. Average monthly enrollment in the Access for Infants and Mothers (AIM) program is expected to be 1,606 women and infants, slightly higher than the 1,601 originally estimated in the Governor's Budget.

Budget Year

The May Revision projects an overall expenditure decrease of $5.5 million from the level anticipated in the Governor's Budget. This decrease of 4 percent in total funds is largely due to federal fund changes resulting from corrections to the way subscriber contributions are budgeted. Based on the revised revenue projection for Proposition 99 funds, there is insufficient funding in 2007-08 for the AIM program. As a result, the May Revision proposes that Proposition 99 transfer authority be reduced by $8.3 million and that General Fund be used to backfill this need.

There is no change in the projected average monthly caseload of 1,159 women reflected in the Governor's Budget. To control program costs, the Managed Risk Medical Insurance Board will maintain capitation rates at their current level. However, the average monthly capitation rate did increase slightly due to the distribution of enrollment among available health plans.

County Health Initiative Matching Fund Program

The County Health Initiative Matching Fund Program allows county or local public agency funds to be used to match unused federal State Children's Health Insurance Program funds to provide health care for uninsured children in families with incomes up to 300 percent of the federal poverty level. These county programs are frequently referred to as Healthy Kids Programs. Expenditures are expected to decrease by $309,000 ($108,000 county funds and $201,000 federal funds) in 2006-07 and by $357,000 ($125,000 county funds and $232,000 federal funds) in 2007-08 due to updated county caseload and expenditure information.

Department of Developmental Services

- 2006-07 -$23.1 million
- 2007-08 $35.9 million

Developmental Centers

Current Year

At 2,877 residents, the average Developmental Center (DC) population is projected to be 43 residents higher than projected in the Governor's Budget. This change is primarily a result of fewer Agnews Developmental Center consumers transitioning into the community due to delays in development of specialized housing. The May Revision includes an increase of $4.4 million ($3.2 million General Fund and $1.2 million reimbursements) and 66 positions due to this increase in population. The General Fund increase is offset by a transfer from the regional center budget.

Budget Year

The average DC population is projected to increase by 21 residents over the Governor's Budget projection, to 2,610 residents. The May Revision includes a decrease of $89,000 General Fund and an increase of $2.2 million reimbursements, reflecting the following major changes:

- Population—The May Revision includes a decrease of $1.1 million ($804,000 General Fund) and 38.5 positions, including an increase of 27.0 Level-of-Care positions due to the increase in estimated DC population, primarily at Agnews Developmental Center, and a decrease of 65.5 non-Level-of-Care positions related to an overall decrease in population at the other state developmental centers.

- Salary Enhancements for Dental Professionals (Perez Case)—The May Revision includes an increase of $1.3 million ($747,000 General Fund) in order to provide salary increases to all budgeted Department of Developmental Services dental staff to retain existing staff and enhance the recruitment of additional staff. This funding will increase salaries for dental staff by between 36 to 58 percent.

- Salary Enhancements for Mental Health Professionals (Coleman Case)— The May Revision includes an increase of $286,000 ($167,000 General Fund and $119,000 reimbursements) to fund salary increases ranging from 66 to 74 percent for psychiatrists and senior psychologists and salary increases ranging from 10 to 40 percent for all other impacted mental health classifications. Budget Bill language also is proposed to allow increased funding if recruitment efforts exceed the proposed staffing plan.

- Intermediate Care Facility/Developmental Disabled Quality Assurance Fee— The May Revision includes a decrease of $774,000 ($452,000 General Fund) to reflect current population and expenditure projections related to the Quality Assurance Fee (QAF) assessment for Intermediate Care Facility/Developmental Disabled (ICF/DD) facilities. The federal government will reduce the current 6 percent QAF on ICF/DDs to 5.5 percent effective January 1, 2008.

- Agnews Developmental Center Closure—State Employees in the Community— The May Revision includes an increase of $242,000 ($129,000 General Fund) and six positions to provide administrative support for state employees in the community effective January 1, 2008. As part of the Agnews closure process, up to 200 state employees are authorized to provide services and support to Agnews consumers in the community. These six administrative support positions are included as part of that authority.

Regional Centers

Current Year

Compared to the Governor's Budget, Regional Center community caseload is projected to decrease by 975 consumers, to 211,180 consumers. The May Revision includes a net decrease of $13.5 million ($23.1 million General Fund) for Regional Centers to recognize lower actual expenditures for Operations and Purchase of Services.

Budget Year

Compared to the Governor's Budget, Regional Center community caseload is projected to decrease by 1,370 consumers, to 219,230 consumers. The May Revision includes a net increase of $31.1 million (an increase of $33.3 million General Fund and a decrease of $2 million other funds), reflecting the following changes:

- Purchase of Services—The May Revision reflects a net increase of $39.4 million (increase of $46.9 million General Fund and a decrease of $7.5 million other funds) for residential and other services driven by required caseload ratios and entitlements. These services include Community Care Facilities, Health Care, Health Facilities, In-Home Respite, and Day Programs. Clients are decreasing by 1,370, while utilization and costs for services are estimated to increase by one percent over the Governor's Budget. This is due to an increase in the number of consumers dually diagnosed with mental health conditions, an increase in persons diagnosed with autistic disorders, and increased demand for support services.
- Staffing—The May Revision reflects a decrease of $3.3 million (a decrease of $10.5 million General Fund and an increase of $7.2 million other funds) to reflect reductions in population estimates since the Governor's Budget and delays in implementation of community placement plans.
- Self-Directed Home and Community-Based Services Waiver—The May Revision reflects an increase of $1.1 million ($574,000 General Fund) and 32 phased-in positions for the implementation of the Self-Directed Services (SDS) program. This revised assumption reduces the Department of Developmental Services funding request by $405,000 ($203,000 General Fund), delays the implementation date associated with the SDS program until March 2008 and reduces the anticipated number of enrollees during 2007-08 from 600 to 400. Implementation of the SDS program is contingent on the federal Centers for Medicare and Medicaid Services' approval of the Community Based Services Waiver, which is expected in March 2008. The California Developmental Disabilities Information System (CADDIS) has been discontinued, so a new SDS information system will need to be developed to support the requirements related to the SDS program.
- Transportation—The May Revision includes a reduction of $15.2 million in Public Transportation Account funds as a technical adjustment that will not impact services. This adjustment is necessary to account for reduced transportation costs and for the

non-medical transportation funding that is included in the Intermediate Care Facility/ Developmental Disabled Bundled Rate Proposal in the Governor's Budget.

Department of Mental Health

- 2006-07 -$25.9 million
- 2007-08 $18.6 million

Long-Term Care / State Hospitals

Current Year

The May Revision reflects decreased funding for long-term care and state hospitals of $25.9 million General Fund due to the following major adjustments:

- State Hospital Population—A decrease of $24.9 million General Fund to reflect a reduction in the Judicially Committed/Penal Code population of 487 patients, including a decrease of:
  - 71 Incompetent to Stand Trial (IST) patients
  - 68 Not Guilty by Reason of Insanity (NGI) patients
  - 106 Mentally Disordered Offenders (MDOs)
  - 242 Sexually Violent Predators (SVPs)
- The decrease across commitment categories is primarily due to staffing shortages within the state hospitals and a re-estimation of the impact of Chapter 337, Statutes of 2006 (SB 1128) and Jessica's Law, resulting in a reduction of 50 percent in the number of SVP commitments estimated in the Governor's Budget.
- SVP Evaluations and Court Testimony—An increase of $366,000 General Fund for SVP evaluation services, based on actual data from implementation of SB 1128 and Jessica's Law, and a decrease of $527,000 General Fund for headquarters positions and consultant services in the Sex Offender Commitment Program.

Budget Year

Funding for long-term care and state hospitals is anticipated to decrease by a net $12.4 million (a decrease of $12.6 million General Fund and an increase of

$176,000 Realignment reimbursement) in 2007-08. The change is comprised of the following adjustments:

- State Hospital Population—A net decrease of $10.4 million (a decrease of $10.6 million General Fund and an increase of $176,000 in Realignment reimbursement):
  - An increase of $4.4 million General Fund to reflect an anticipated increase in the Judicially Committed/Penal Code population of 38 patients, including an increase of 158 IST patients, 46 NGI patients, 54 MDOs, and a decrease of 220 SVPs. The increase in IST, NGI, and MDO patients is based on an anticipated increase in staffing resulting from recent salary increases. The decrease in the SVP population reflects the revised estimated impact of SB 1128 and Jessica's Law.
  - A decrease of $28.2 million General Fund to reflect full-year impact of the current year reduction in the state hospital population of 487 patients. This decrease is in addition to the $21.7 million General Fund reduction previously requested in an April Finance Letter.
  - An increase of $5.9 million ($5.8 million General Fund and $144,000 in Realignment reimbursement) to provide funding for salary increases. This request funds salary increases ranging from 66 to 74 percent for psychiatrists and senior psychologists and salary increases ranging from 10 to 40 percent for all other impacted mental health classifications. Budget Bill language also is proposed to allow for increased funding for these salaries if more vacancies than anticipated are filled, or for contract costs for registry funding, if necessary.
  - An increase of $1.6 million ($1.6 million General Fund and $32,000 in Realignment reimbursement) to provide all budgeted Department of Mental Health dental staff with salary increases ranging from 36 to 58 percent.
  - An increase of $4.3 million General Fund to contract for competency restoration services. Contracting for local beds will expedite services, reduce the average length of stay, and address state hospital capacity issues. Additionally, the May Revision includes $696,000 General Fund for four Level-of-Care positions and associated costs to run an 18 bed unit at the Salinas Valley Psychiatric Program for IST patients too dangerous to reside within state hospitals.
- Forensic Conditional Release Program (CONREP)—The May Revision includes an increase of $929,000 General Fund, to increase CONREP capacity by 30 beds. This will free up 30 additional state hospital beds by addressing the current backlog of patients

waiting to enter CONREP and fund a projected increase in the number of hospital liaison visits.

- SVP Evaluations and Court Testimony—The May Revision includes a net decrease of $2.9 million General Fund, primarily for SVP evaluation services based on actual data from implementation of SB 1128 and Jessica's Law.

Community Mental Health Services

The May Revision includes a net increase of $65.6 million ($31.1 million General Fund and $34.5 million in federal fund reimbursement) for community mental health services relative to the Governor's Budget. The major adjustments include the following:

- Early and Periodic Screening, Diagnosis and Treatment (EPSDT) Program—The May Revision includes an increase of $67.4 million ($32.1 million General Fund and $35.3 million in federal fund reimbursement) in 2007-08. This includes the following adjustments:
    - A decrease of $24.3 million ($12.2 million General Fund and $12.1 in federal fund reimbursement) due to lower than projected EPSDT claims.
    - An increase of $61.6 million ($30.8 million General Fund and $30.8 million in federal fund reimbursement) to remove the cost settlement adjustment factor. Upon its review of the EPSDT estimation methodology this spring, the Office of State Audits and Evaluations (OSAE) recommended eliminating the cost settlement adjustment historically used to discount claims estimates.
    - An increase of $39.9 million ($17.2 million General Fund and $22.7 million in federal fund reimbursement) for the 2004-05 cost settlement.
    - OSAE will conduct a review of EPSDT local assistance programs and an internal control review of the DMH's accounting and administrative controls. The reviews are expected to be completed by September 2007 and January 2008, respectively, with a DMH action plan issued in March 2008.
- Mental Health Managed Care Program—The May Revision includes a decrease of $1.9 million ($926,000 General Fund and $926,000 in federal fund reimbursement from the Department of Health Services), primarily due to a decrease in the number of Medi-Cal eligibles receiving psychiatric inpatient hospital services and specialty mental health professional services.

Department of Social Services

- 2006-07 $9 million
- 2007-08 -$141.2 million

CalWORKs

The 2006-07 average monthly CalWORKs caseload of 461,200 represents a decrease of 3.1 percent from 2005-06, and a reduction of 1.3 percent from the Governor's Budget estimate. For 2007-08, the caseload is now expected to be 404,300, a decrease of 12.3 percent from the revised 2006-07 caseload reflected in the Governor's Budget. Combined federal Temporary Assistance for Needy Families Block Grant and state and county maintenance-of-effort expenditures in 2006-07 and 2007-08 are anticipated to be $7 billion.

The May Revision continues to reflect the Administration's proposals for major CalWORKs reform measures that emphasize work participation and personal responsibility, improve the state's ability to meet federal requirements, and make the program more efficient. The May Revision incorporates methodology changes and updated caseload projections to more accurately reflect the estimated impact of CalWORKs reform, including implementing full family sanctions for long-term non-compliance, modifying the safety net program to increase work participation, and establishing time limits for families with drug felons and other ineligible adults. Although this has resulted in a savings erosion of $9.9 million since the Governor's Budget, the reform measures are projected to improve the state's work participation rate by more than 6 percent in 2007-08 and over 11 percent annually thereafter.

The May Revision includes one-time costs of $17.2 million ($3.7 million General Fund) in 2007-08 for automation changes necessary to implement a semi-annual reporting system for CalWORKs and food stamp recipients in 2008-09. The semi-annual reporting system is expected to simplify reporting requirements for families and make it easier for counties to administer the program. This proposal will generate savings compared to the current quarterly reporting requirements and have a positive impact on work participation.

Supplemental Security Income/State Supplementary Payment Program

Total General Fund expenditures for the Supplemental Security Income/State Supplementary Payment (SSI/SSP) program are $3.5 billion in 2006-07, representing a decrease of $11.4 million compared to the Governor's Budget. The SSI/SSP General Fund expenditures for 2007-08 are $3.6 billion, a decrease of $262.3 million from the Governor's Budget, primarily resulting from suspension of the January 2008 cost-of-living adjustment (COLA). Caseload for the SSI/SSP program is projected at 1,228,000 recipients in 2006-07 and 1,250,400 recipients in 2007-08, a year-to-year caseload growth of 1.8 percent.

The May Revision proposes to suspend the January 2008 state COLA in the SSI/SSP program. This will result in a savings of $184.7 million in 2007-08 and ongoing savings of $369.5 million in future years. Due to pass-through of the federal COLA on January 1, 2008, monthly grant payment levels will increase from $856 for aged or disabled individuals and from $1,502 for aged or disabled couples to $863 and $1,514 respectively. California's SSI/SSP payment levels for individuals and couples are projected to maintain rankings of second and first in the nation, respectively (Figure HHS-01).

Figure HHS-01

Comparison of Five Highest SSI/SSP Maximum Payments

Monthly Grants for Independent Living Arrangement
as of January 1, 2006

	Aged and Disabled	
State	**Individuals**	**Couples**
Alaska	$965	$1,432
California [1]	836	1,472
Connecticut	771	1,144
Massachusetts	732	1,106
New York	690	1,008
Average maximum combined payment level of remaining states that provide a supplemental payment:	$637	$974
Maximum combined payment level of remaining states that only provide an SSI payment: [2]	$603	$904

[1] Reflects payment levels in effect April 1, 2006. On January 1, 2007, California's SSI/SSP payments increased to $856 for individuals and $1,502 for couples. Effective January 1, 2008, payments will increase to $863 and $1,514 for individuals and couples, respectively.

[2] As of January 2006, 28 states did not provide a supplemental payment.

In-Home Supportive Services

Total General Fund expenditures for the In-Home Supportive Services (IHSS) program are $1.5 billion in 2006-07 and $1.6 billion in 2007-08, including an increase of $30.4 million in 2006-07 and $85.6 million in 2007-08 compared to the Governor's Budget. Caseload is projected to be 370,300 recipients in 2006-07 and 389,100 in 2007-08. Although this represents a year-to-year caseload growth of 5.1 percent, the caseload estimates in 2006-07 and 2007-08 are slightly less than projected in the Governor's Budget. The May Revision retains the proposal to limit state participation in the cost of IHSS wages and health benefits at the levels in effect in the current year. Significant General Fund adjustments include:

- An increase of $8.2 million in 2006-07 and $35.7 million in 2007-08 to fund IHSS provider wage and/or health benefit increases provided in 19 counties since the Governor's Budget, partially offset by lower-than-projected caseload growth.
- An increase of $33.2 million in 2006-07 and $48.5 million in 2007-08 to reflect a lower level of savings resulting from the IHSS Quality Assurance program. The program was implemented to ensure that individuals receive necessary services consistently across the state and to help control costs. Less savings are assumed based on actual implementation data.
- A decrease of $11 million in 2006-07 due to a delay in implementation of the Case Management Information and Payrolling System II.

Child Welfare Services

The child welfare services system in California provides a continuum of services through various programs, including Child Welfare Services, Child Abuse Prevention, Foster Care, Adoption Assistance, and Adoptions to children who are either at risk of or have suffered abuse and neglect. The May Revision includes $4 billion ($1.6 billion General Fund) to provide assistance payments and services to children and families under these programs. This is a $16.5 million ($17.8 million General Fund) increase from the Governor's Budget.

The May Revision includes a proposal to establish statewide consistency and avoid double payment in rates for children who receive adoption or foster care payments from the Department of Social Services as well as services from the Department of Developmental Services. The Administration proposes to establish a standard monthly rate of $2,006 for adoption and foster care payments to create statewide consistency in rates. The new rate will be effective on July 1, 2007. Families currently receiving a payment below the standard will receive an increase. Families with higher rates will continue to receive the higher rate. Children will continue to receive all necessary services related to their developmental disability through the regional center system. Establishment of a standard rate will result in anticipated savings of $7.1 million General Fund in 2007-08. This proposal includes trailer bill language to ensure that each child's Individual Program Plan takes into account the flat rate received for board and care with the goal of preventing the state paying twice for the same service.

Corrections and Rehabilitation

The May Revision continues the Administration's commitment to public safety and rehabilitation in programs operated by the Department of Corrections and Rehabilitation (CDCR).

- 2006-07 -$4.6 million
- 2007-08 $113 million

The May Revision proposes an increase of $113 million General Fund for the CDCR, including the following:

Expansion of Capacity and Rehabilitative Programs

On May 3, 2007, the Governor signed AB 900 (Chapter 7, Statutes of 2007), which provides for a critical expansion of capacity in the state prison system. AB 900 emphasized expanding rehabilitative programs and measuring outcomes through performance goals to reduce the high rate of recidivism among adult offenders.

AB 900 appropriated $50 million for the CDCR to expand rehabilitative programs. AB 900 also authorized the construction of additional infill beds at existing facilities and the creation of re-entry facilities for the incarceration of inmates who have served the majority of their terms near the communities into which they will eventually be released.

The May Revision does not include funding for all of the potential fiscal impacts associated with AB 900. The Governor has convened multi-disciplinary "Strike Teams" to review and make recommendations on the programmatic and construction-related aspects of AB 900 implementation. Once the Strike Teams have evaluated the fiscal implications of AB 900, implementation plans and resource needs beyond those appropriated in AB 900 will be presented to the Legislature. The May Revision includes the following:

Teacher Vacancies

An increase of $11.7 million General Fund in 2007-08 and $27.8 million in 2008-09 to fill vacant teacher positions in adult institutions. By filling teacher vacancies, the CDCR will be able to provide educational and vocational services to an additional 6,372 inmates annually.

Out-of-State Beds

An increase of $9.6 million in 2007-08 and $14.6 million in 2008-09 to reflect the transfer of up to 5,060 inmates to correctional facilities in other states. AB 900 authorizes these transfers, and this will provide immediate relief for overcrowding in the prison system and enhance the safety of the conditions under which employees work and inmates are housed.

State and Local Facilities

An increase of $581,000 General Fund for the CDCR's Office of Facilities Management to provide immediate staffing needs to support the prison construction projects authorized by AB 900 and $2 million General Fund for the Corrections Standards Authority to administer the local jail bed construction grants authorized by AB 900.

Dental and Mental Health Plans

The enactment of AB 900 will allow the CDCR to begin to address the much-needed space issues for mental health care and dental care. The design and construction of six mental health projects resulting in beds or treatment space for 775 inmates at a cost of $199.6 million as well as $285 million for dental facilities at seven institutions will be allocated from the $857.1 million in lease revenue bond authority granted in Phase I of AB 900 for the purpose of mental health, medical, and dental care. The CDCR continues to refine the estimated costs for the balance of the approximately 4,000 mental health beds that have been proposed to the Coleman court in the December 2006 Mental Health Bed plan. The CDCR will be working in conjunction with the Coleman and Perez courts and the federal Receiver appointed by the Plata court to provide the most efficient, consolidated use of space to provide constitutionally adequate health care to all CDCR inmates.

Other Related Adjustments

In addition to the items noted above, the May Revision reverses the savings that were assumed for direct discharge and diagnostic evaluations and removes the funds proposed for creation of the California Sentencing Commission. The Administration is withdrawing the proposed statutory changes that accompanied these savings and expenditure proposals. However, the Administration continues to seek statutory authority proposed in the Governor's Budget for up to 4,500 beds in Female Rehabilitative Community Correctional Facilities.

Program Enhancements and Other Budget Adjustments

The May Revision reflects changes to the CDCR's adult, juvenile and parolee population, as well as other policy, caseload and court-driven adjustments.

Anti-Gang Efforts

Criminal Intelligence Analysis Unit

$8.5 million is proposed in 2007-08 for the CDCR to aggressively address the prison gang problem by implementing a sophisticated gang intelligence-gathering and analysis system statewide. The Criminal Intelligence Analysis Unit (CIAU) will be staffed by specialized criminal intelligence gang investigators and analysts. CIAU experts will track the expansion of criminal enterprises and build computerized databases to provide federal, state and local law enforcement with vital information. Included in this proposal is a $5.5 million grant from the state Office of Homeland Security to create a Threat Assessment Center to help coordinate the analysis and dissemination of gang intelligence.

Regional Gang Task Forces

$3.3 million is proposed for the CDCR to create three pilot task forces for Los Angeles, the Bay Area, and the Inland Empire to work with local law enforcement to disrupt gang activity in their areas. These special agents will utilize the information generated by the CIAU to search out and destroy organized gang crime by collaborating with police officers, sheriff's deputies, prosecutors and various federal agencies.

Project IMPACT

$820,000 is proposed to operate Project IMPACT (Incarcerated Men Putting Away Childish Things) in more juvenile justice facilities, and to create two 10-bed transitional homes in Northern and Southern California communities. Adult gang members developed Project IMPACT to free younger gang members from the violent cycle of crime and incarceration.

Adult Inmate/Parolee Population/Caseload Changes

Current Year

Based upon the latest estimates, including the most recent actual population data, the May Revision reflects an estimated institutional Average Daily Population (ADP) of 172,369 inmates for the current year. This is 1,032 less than projected in the 2007-08 Governor's Budget. This is due to a slower rate of new admissions from the courts and a lower number of parole violators with new terms than projected.

The projected parolee ADP is 120,717 for the current year. This is an increase of 1,569 from the number projected in the Governor's Budget.

The net effect of these population changes is an increase to the General Fund of $3.3 million and an increase of $622,000 to the Inmate Welfare Fund.

Budget Year

The May Revision reflects an estimated institutional ADP of 174,300 inmates for the budget year. This is 3,277 less than projected in the Governor's Budget. The decrease in population is mainly due to a projected decrease in new admissions from the court and parole violators with new terms.

The projected parolee ADP is 124,862 for the current year. This is an increase of 2,714 from the number projected in the Governor's Budget. The parole population is expected to increase due to a significant increase in the number of inmates released to parole. The population changes will reduce costs to the General Fund by $46.0 million and reduce costs to the Inmate Welfare Fund by $974,000.

The May Revision also reflects a reduction of 1,039 institutional ADP and 4,397 of parolee ADP resulting from the discharge of parolees after 12 months of clean time. The effect of this change is $31.2 million General Fund in 2007-08 and $58.3 million in 2008-09 and ongoing.

Adult Local Assistance

The May Revision includes $16.9 million to fully fund local entities for costs incurred for the prosecution of inmate crimes, housing state inmates, and various other county services related to state inmates.

The Governor's Budget provided $15.3 million for the costs associated with prosecuting crimes committed by state inmates and other county services related to state inmates. Based on claims received, the projected total cost of claims for 2007-08, including the outstanding balance from 2006-07, will be $24.6 million, resulting in a shortfall of $9.3 million. The May Revision includes $7.8 million in one-time funding for 2007-08 to pay the outstanding current-year claims, along with $1.5 million to adequately fund the base to pay projected claims in 2007-08.

In 2005-06, the Administration, working with representatives of local law enforcement entities, created a methodology to establish the Daily Jail Rate based on the state's costs to house similar inmates and provide routine medical care. At that time, the Administration committed to reassessing and revising the Daily Jail Rate each year based on this methodology. The revised Daily Jail Rate for 2007-08 will increase from $71.57 to $77.17. The May Revision includes an additional $1.5 million to reimburse local entities for the costs of housing state inmates and supplying routine medical care at the revised rate. The May Revision also includes $6.1 million to reimburse the Los Angeles County Sheriff's Department for the delay in moving inmates out of the Pitchess Detention Center.

Finally, the May Revision proposes statutory changes intended to ensure that local entities submit their claims to either the CDCR or the State Controller in a timely manner.

Other Adult Population Adjustments

Peace Officer Selection Unit

The May Revision includes $18.7 million in 2007-08 to augment the CDCR's peace officer recruitment efforts. The CDCR will take aggressive steps to fill its correctional officer academies. These funds will be used for marketing and advertising, and to address the expected significant increase in applications for correctional officer positions.

Ward/Parolee Population/Caseload Changes

Current Year

For 2006-07, the May Revision estimate for the year-end juvenile institution population is 2,450, a decrease of 180 wards from the projection in the Governor's Budget. This decrease is primarily due to fewer juvenile court first admissions. In addition, the year-end juvenile parole population is projected to be 2,765, a decrease of 10 parolees from the Governor's Budget projection. Despite the ward and parolee population decline, an additional $1.2 million is requested to address cadet training costs at the R.A. McGee Correctional Training Center and to meet the staffing ratios necessary to maintain compliance with the court orders issued in the Farrell v. Allen lawsuit.

General Fund expenditures for juvenile institutions are partially offset by General Fund revenues from the sliding scale fees paid by counties. In 2006-07, these revenues are estimated to be $16.2 million, a decrease of $568,000 from the revenue expected at the time of the Governor's Budget.

Budget Year

For 2007-08, the year-end juvenile institution population is projected to be 2,340, a decrease of 150 wards from the projection included in the Governor's Budget. This decrease is primarily due to fewer juvenile court first admissions. Additionally, the year-end juvenile parole population is estimated to be 2,385, a decrease of 20 parolees since the Governor's Budget estimates. The effect of these population changes is decreased costs to the General Fund of $2.5 million, which reflects the closure of one Division of Juvenile Justice (DJJ) facility.

In 2007-08, the sliding scale fees paid by counties are estimated to be $15 million, a decrease of $807,000 compared to the revenue expected at the time of the Governor's Budget.

Correctional Health Care Services

The May Revision proposes $45.9 million General Fund in 2007-08 to address various court requirements related to the provision of medical, dental, and mental health care services. Specifically, the May Revision includes the following adjustments:

- Health Care Services Administration Funding—To better address cross-cutting activities related to the Plata, Perez, and Coleman lawsuits, the Administration proposes to add $25 million General Fund in 2007-08 to the $150 million proposed in the Governor's Budget for activities of the Receiver appointed by the Plata court and to make this total of $175 million in funding available to the Receiver and for coordinated efforts of the Plata, Perez and Coleman courts to address shared administrative and program efforts, such as health care information technology projects, contract management, and pharmacy services.

- Ongoing Plata Receivership Costs—The Budget Act of 2006 included $100 million for activities of the Receiver appointed by the court in the Plata lawsuit. The Governor's Budget included an additional $50 million for 2006-07. Since the Governor's Budget, approximately $28.7 million in additional funds have been transferred, for a total of approximately $79 million transferred to date in 2006-07. These transfers result in ongoing costs of approximately $73.2 million in 2007-08. The May Revision proposes approximately $18.2 million, in addition to the $54.6 million proposed in the Governor's

Budget, for the ongoing costs of the transfers requested by the Receiver in the current year.

- Inmate Dental Services Program—$2.7 million General Fund to allow the CDCR to rollout Phase IV of the Inmate Dental Services Program as required by the stipulation reached in the Perez lawsuit and to provide additional headquarters staffing within the Dental Program.
- Hiring Plan for Dental and Mental Health Programs—Additional position authority to allow the CDCR to address its difficulty in hiring and retaining necessary dental and mental health professionals. This proposal is primarily designed to provide the CDCR with dedicated staff to expedite its hiring process so it can fill critical positions within the dental and mental health programs. The positions will be funded within existing resources and will complement the $1 million proposed in an April 1 Finance Letter for the Department of Personnel Administration to recruit additional dental and mental health professionals.
- In addition to these court-driven issues, the May Revision also proposes to transfer all health care guarding and transportation costs to the Health Care Services Program. This will better enable the Health Care Services Program to manage and oversee guarding and transportation costs related to the health care programs. This will result in a net zero impact on the CDCR's budget, but will align resources within the program where the expenditures are incurred.

Other Court-Driven Augmentations

- Coleman Cell Modifications—$4.6 million one-time General Fund to continue state efforts to reduce the potential for suicides within cells where suicides are most prevalent in response to the Coleman court's orders. This proposal would allow the CDCR to retrofit 124 existing mental health acute care cells at the California Medical Facility to remove all hanging attachment sites. This proposal would also allow the CDCR to modify or replace vent screens in 2,235 mental health cells within 45 administrative segregation units at 28 prisons statewide.
- Valdivia Parole Revocation Process Monitoring—$1.6 million General Fund to provide staff dedicated to the compliance and monitoring of the parole revocation process. This proposal would allow the CDCR to accelerate its compliance with court orders and ultimately this class action lawsuit.

- Rutherford Transcription Services—$1.3 million General Fund to provide contract funding for the Board of Parole Hearings to transcribe lifer hearings and place the transcription online.
- Armstrong Remedial Plan—$2.8 million General Fund in 2006-07 and $7.4 million in 2007-08 to comply with a federal injunction requiring compliance with the Americans with Disabilities Act (ADA) within correctional facilities. This plan would enhance tracking of ADA inmates, establish ADA compliance and tracking positions within facilities, and create and staff a new correctional sign language interpreter classification. Funding and staff are being proposed on a two-year limited term basis.

The Receiver submitted his budget proposal to the Administration and the Legislature on May 11, 2007. The Administration will immediately begin reviewing that proposal with the intent to provide its recommendations and funding options to the Legislature prior to the commencement of the Budget Conference Committee.

Update to the Local Housing of the Juvenile Justice Population

The May Revision reflects a net decrease of $7.2 million General Fund as a result of adjusting the per capita cost for housing wards within the DJJ to reflect 2007-08 costs and revising the number of juvenile offenders that will be housed locally based on updated estimates of intake. The Governor's Budget assumed that the DJJ's institution population would be reduced by 1,338 juvenile offenders by June 30, 2008. The DJJ's institution population is now projected to decrease by 931 juvenile offenders by June 30, 2008.

California Adult Probation Accountability and Rehabilitation Act

The May Revision proposes $25 million in ongoing funding for the California Adult Probation Accountability and Rehabilitation Act (CAPARA) to provide all local probation departments with a dedicated funding source to increase the effectiveness of adult probation services in California. The CAPARA is designed to support statewide local probation department efforts to reduce crime through improved rehabilitative services and increased supervision of adult probationers ages 18 to 25.

K thru 12 Education

Kindergarten through 12th grade (K-12) education programs provide a variety of academic and support services primarily to pupils between the ages of three and 19. The programs equip California's young people with the skills to become successful adults, achieve career goals, obtain gainful employment and pursue higher education. Services include standards-based academic instruction, special education, career technical education programs, child care and development, teacher recruitment and development and adult education and remedial instruction, among others.

Change in Total K-12 Funding

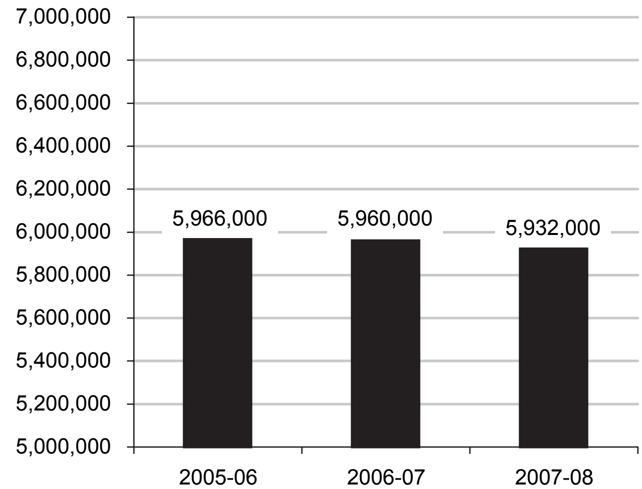
- 2006-07 $172 million
- 2007-08 $297 million

The May Revision to the Governor's Budget includes $66.6 billion ($41.4 billion General Fund and $25.2 billion other funds) for K-12 education programs in 2007-08. This reflects an increase of $297.5 million ($855.8 million General Fund increase offset by a $558.3 billion other funds decrease) over the 2007-08 Governor's Budget. More notable funding changes are further described below.

As a result of a steady decline in birth rates throughout the 1990s, attendance growth in public schools is also declining (see Figure K12-01). For the current year, K-12 average daily attendance (ADA) is estimated to be 5,960,000, a decrease of 5,000 or 0.09 percent from the 2005-06 fiscal year. For the budget year, the Administration estimates K-12 ADA will decrease at a greater rate than projected in the Governor's Budget. The May Revision projects a decline of 28,000 ADA or 0.48 percent, compared to the 23,000 or 0.39 percent

Figure K12-01

K-12 Average Daily Attendance



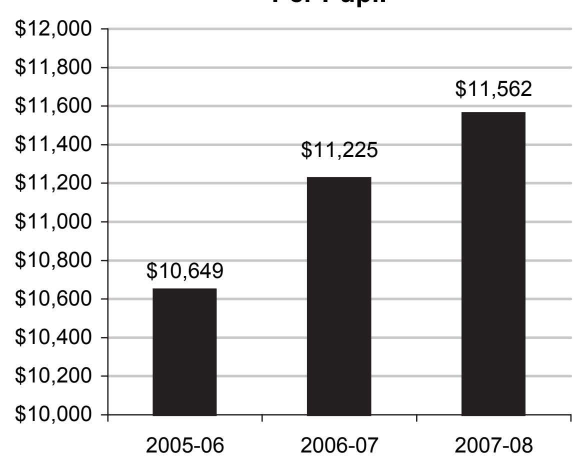
decline projected in the Governor's Budget. As a result, ADA for 2007-08 is now projected to be 5,932,000.

Per-Pupil Spending

Total per-pupil expenditures from all sources are projected to be $11,225 in 2006-07 and $11,562 in 2007-08, including funds provided for prior year settle-up obligations (see Figure K12-02). This is an indicator of the relative level of spending in California for support of K-12 education programs and not the actual level of funding allocated to each school for a pupil.

Figure K12-02

K-12 Education Total Spending Per Pupil



Major Workload Adjustments

Major workload adjustments for 2007-08 include the following:

- Cost-of-Living Adjustment (COLA) Increases—The May Revision proposes a $226.8 million increase to fund an increase in the statutory COLA: $160.8 million for revenue limits, $17.8 million for special education, $7.5 million for child care programs, $9 million for class size reduction, and $31.7 million for various categorical programs. The COLA increases to 4.53 percent from the 4.04 percent adjustment included in the Governor's Budget.
- ADA—The May Revision proposes a $293.3 million net reduction in 2007-08 to reflect the decline in ADA from the Governor's Budget projection. The majority of this amount consists of a $285.6 million reduction in school district and county office of education revenue limit apportionments (general purpose funding for schools). Due to an increase in the attendance estimate for 2006-07, there is a $41.2 million increase in revenue limit apportionments included in the May Revision for that year.
- Special Education—The May Revision provides a Proposition 98 General Fund increase of $35.9 million and a Federal Fund increase of $7.6 million over amounts proposed in the Governor's Budget. These changes include adjustments for revised figures for local property tax and ADA growth.

The major policy adjustments included in the Budget are discussed in Program Enhancements and Other Budget Adjustments.

Proposition 98 Guarantee

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

Proposition 98 originally mandated funding at the greater of two calculations or Tests (Test 1 or Test 2). In 1990, Proposition 111 was adopted to allow for a third funding test in low revenue growth years. As a result, three calculations or Tests determine funding for school districts and community colleges (K-14). The calculation or Test that is used depends on how the economy and General Fund revenues grow from year to year (see Figure K12-03).

For fiscal year 2005-06, Proposition 98 funding was $53.3 billion (this number reflects the guarantee level as recalculated pursuant to the Proposition 98 Settlement Agreement), of which the General Fund share was $39.7 billion or 74.5 percent. Local property taxes covered the balance. The 2006-07 Proposition 98 funding is estimated to be $55.4 billion, a 3.9 percent increase over 2005-06. The General Fund share in 2006-07 is $41.2 billion or 74.4 percent. These funding levels reflect the higher attendance estimates and the cost of apportionments for that year.

Proposition 98 funding for 2007-08 is proposed at $57.6 billion, a four percent increase over the Governor's Budget estimate. The General Fund comprises approximately 72.7 percent, or $41.9 billion of total proposed Proposition 98 funding. The totals include funding for K-12, community colleges and other state agencies that serve students. K-12 Proposition 98 per-pupil expenditures in the May Revision are $8,681 in 2007-08, up from $8,569 in the Governor's Budget.

Figure K12-03

Propositon 98 Test Calculations

Test 1—Percent of General Fund Revenues

Test 1 is based on a percentage or share of General Fund tax revenues. Historically, school districts and community colleges (K-14) received approximately 40 percent in the 1986-87 fiscal year. As a result of the recent shifts in property taxes between K-14 schools and cities, counties, and special districts, the current rate is approximately 41 percent.

Test 2—Adjustments Based on Statewide Income

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

Test 3—Adjustment Based on Available Revenues

Test 3 is utilized in low revenue years when General Fund revenues decline or grow slowly. During such years, the funding guarantee is adjusted according to available resources. A low revenue year is defined as one in which General Fund revenue growth per capita lags behind per capita personal income growth more than one-half percentage point. Test 3 was designed so that education is treated no worse in low revenue years than other segments of the state budget.

In years following a Test 3 funding level, the state is required to provide funding to restore what was not allocated the previous year. This is often referred to as a maintenance factor.

Home-to-School Transportation

The Governor's Budget proposed to shift the fund source for the $627 million Home-to-School Transportation program from Proposition 98 General Fund to the Public Transportation Account (PTA). In April, the Administration issued a revised proposal for Home-to-School Transportation. The revised proposal will continue to result in General Fund savings of $627 million. However, instead of shifting Home-to-School Transportation out of the Proposition 98 guarantee and funding it with PTA moneys, the PTA will reimburse the General Fund for the cost of the Home-to-School Transportation program.

To achieve additional General Fund savings, the May Revision proposes:

- To increase the 2007-08 reimbursement from the PTA for Home-to-School Transportation by $3 million to reflect the increase in the COLA for the program and to reflect $2.6 million in transportation costs for the State Special Schools.
- Reimburse the General Fund for $200 million in 2006-07 Home-to-School Transportation expenditures.

Program Enhancements and Other Budget Adjustments

Governor Schwarzenegger's 2007-08 May Revision continues to reflect his priorities to build and sustain a world-class school system that begins in preschool and continues through college, technical and university training. All Californians must have opportunities to meet the demands of the 21st Century. Towards that end, the Administration once again has committed to fully funding the Proposition 98 guarantee to schools and cost-of-living and enrollment growth.

In recognition of the complex demands of educating over six million students, the May Revision supports programs that are shown to support teachers, students, parents and schools in a standards-based accountability system. These priorities include Career Technical Education, nutrition, technology, preschool and school safety. The Governor's initiatives offer the links necessary for California's students to master the state's world-class academic standards.

Of particular note, the May Revision reflects the Governor's support for ensuring that all students have quality teachers, education programs and professionals to prepare them for both higher education and the world of work. The May Revision includes substantial ongoing and new support for the expansion of Career Technical Education and teachers and counselors to ensure that the many students who directly enter the work force are educated and prepared to succeed.

Consistent with the Governor's lifelong support of physical fitness and healthy lifestyles, the May Revision emphasizes again the need for strong nutrition programs. The Administration proposes ongoing support for the California Fresh Start Program, along with increases for meal reimbursements and School Breakfast Programs in order to increase the quality of food served on campus.

Thanks to Governor Schwarzenegger's efforts, California is rapidly moving into the digital age for information on the state's students and schools. The Administration is committed to expanding and making more transparent information about schools, and towards that end funds new transparency of data initiatives as well as the aggressive deployment of student, teacher and school data systems.

Excellence in our schools is achieved when learning environments are safe. Therefore, the May Revision includes a one-time School Safety Initiative that focuses on the development and deployment of state-of-the art systems, training, and preparation.

Career Technical Education Counselors

The Budget Act of 2006 included $200 million in ongoing funding to increase the number of school counselors serving seventh through twelfth grade students. These funds are being used to inform students about educational and career options and help them stay on track to complete high school graduation requirements and pass the California High School Exit Examination.

Building upon this foundation, the May Revision provides $25 million Proposition 98 General Fund to increase the number of high school counselors that specialize in career technical education (CTE). These funds are intended to supplement, not supplant, existing counseling resources. Because many of our state's high school students have interests that extend beyond traditional academic preparation, it is essential for the state to invest in school counselors that can provide students with educational advice and options that will appropriately prepare them for employment in today's workforce after graduation, or provide them with the career-specific academic skills needed for transitioning into higher-level training at a community college, vocational school or four-year university. The Adminstration proposes minimum grants of $45,000 per high school under a priority distribution methodology that recognizes schools with the highest need based on the numbers of CTE enrollments, career path options, and CTE course sections.

Career Technical Education Equipment

Companion legislation to the Budget Act of 2006 provided $80 million in one-time funding split equally for public schools and community colleges for investments in career technical education equipment and minor facilities reconfigurations. Building on those investments, the May Revision provides an additional $100 million in one-time funding, also split equally, in separate legislation to purchase relevant equipment for programs in public schools and community colleges. Consistent with last year's legislation, eligible K-12 entities once again include school districts, adult education programs, regional occupational centers and programs, as well as charter schools and county offices of education that offer appropriate programs. Of this amount, $2.5 million is earmarked to support equipment purchases for K-12 nursing career pathway programs. These one-time funds complement ongoing resources for career technical education by ensuring that students have access to the latest equipment utilized by technicians in today's workplace to ensure students will be employable in a promising career upon high school graduation or will be ready to transition to higher skill levels in that career sector at the community colleges.

Making School Meals Healthy

The Administration has consistently championed improvements to the foods and beverages available to students on K-12 campuses. Specifically, the Governor's Obesity Initiative resulted in laws that significantly curtailed the availability of fattening, heavily-sweetened, high-caloric unhealthy snack foods and beverages in schools. In addition, the initiative created the California Fresh Start Pilot Program, which provided a financial incentive to promote the consumption, and increase the variety of, nutritious fruits and vegetables available to school-age children. A preliminary review indicates striking success in meeting the goals of the program.

The May Revision builds on the progress made by the Governor's initiative. In particular:

- The May Revision adds $11.1 million Proposition 98 General Fund to permanently establish the California Fresh Start Program.
- $24.9 million Proposition 98 General Fund is included to support a 4.7 cent increase in the meal rate for the School Nutrition Program. This funding is contingent upon enactment of Administration-sponsored legislation that will provide a financial incentive to schools that switch to lower fat cooking methods and reducing trans-fat.
- An additional $4.4 million one-time Proposition 98 Reversion Account is included to provide a total of $5.4 million for School Breakfast Startup grants. The program provides up to $15,000 per school site for initiating or expanding a School Breakfast Program or a Summer Food Service Program. The Budget Act of 2006 provided a total of $4 million, which funded 350 grants. The $5.4 million proposed for 2007-08 would fund an estimated 501 grants.
- Due to the many nutrition standard changes currently underway and on the horizon, the May Revision includes $8.5 million for county offices of education to provide educational services and technical assistance to schools and districts to ensure that these standards are being met. Food service directors and employees at the district and school site level are responsible for the nutritional content of meals, snacks,

and beverages as well as food preparation and financial duties. County offices of education are uniquely positioned to be able to provide assistance and expertise to districts in meeting standards and integrating fresh produce, whole grains and other healthy choices into school meals. Of the $8.5 million, $4.3 million Proposition 98 General Fund will be for ongoing program activities and $4.2 million Proposition 98 Reversion Account will be for one-time implementation activities.

These increases will further enhance the ability of schools to serve nutritious meals to students. By providing nutritious food choices, school nutrition programs play an important role in promoting student health and combating childhood obesity.

Providing Online, User-Friendly Information on Schools

With the release of the Governor's Budget, the Administration committed to developing integrated and transparent systems that are easily accessible to provide meaningful information to parents, the public, educators and policymakers. To this end, the Administration is sponsoring legislation to redesign the School Accountability Report Card so that the information is more parent-friendly, less complicated and provides the relevant district- and site-level information that will allow schools to be compared to one another.

Additionally, in April, the Administration provided $167,000 to develop and administer the Governor's Office Education Transparency Website (Website). While school-specific data is available over the Internet at the present time, the ability to do side-by-side comparisons of schools in a single session is not. The Website will present data in a fashion that is simple and intuitive. The intended audience for this effort is not the researcher or the seasoned professional, but parents or members of the general public who have basic questions about local schools. Specifically, the Website will allow parents and others to compare and contrast data such as enrollment, test scores, course offerings, student/teacher ratios, and some district-level financial information on per-pupil expenditures.

In an effort to strengthen fiscal transparency for the public, the May Revision includes $300,000 Proposition 98 General Fund for the Fiscal Crisis and Management Assistance Team to coordinate, along with the Department of Education, a working group to develop criteria and definitions within the state's Standardized Account Code Structure for the purpose of tracking district revenues and expenditures at the school-site level. An additional position within the Department of Education would serve as the coordinator and support staff for the working group. Currently, most districts report financial data as aggregates at the district level, making it difficult for parents, community members, and policy makers to assess fiscal issues concerning individual school sites.

Expanding PreKindergarten Family Literacy

The May Revision provides an additional $50 million in ongoing Proposition 98 funding for the second phase of a three-year initiative to expand preschool opportunities for 4-year-olds residing in attendance areas of schools ranked in the lowest three deciles of the 2005 Academic Performance Index. This funding will expand the provisions of the PreKindergarten Family Literacy (PKFL) program authorized by Chapter 211, Statutes of 2006 (AB 172). The PKFL program includes quality reforms designed to promote family literacy. The $50 million will bring total funding for PKFL to $100 million and total state funding for preschool programs to $470.7 million.

Included in the PKFL program is $5 million earmarked to provide up to $2,500 per classroom for support activities, including professional development for preschool teachers. The Administration is proposing to extend the $2,500 per classroom to all state subsidized preschool programs with priority given to PKFL programs. This will allow funds to benefit a larger population of children while maintaining the focus on targeted preschools under the PKFL program.

In addition, the May Revision continues to propose $5 million in ongoing Proposition 98 funding to provide full day wrap-around care for children in PKFL programs. Wrap around care provides an opportunity for children of parents who work full-time to participate in preschool and still receive quality child care for the remainder of the day.

Meeting California's Information Needs

Timely and accurate information is increasingly critical in the education decision-making process at all levels, from local school site decisions to decisions made at the federal level. The Administration remains committed to enhancing the quality of data available on the State's student population and teacher workforce. To support this effort, the Governor's Budget included $2.5 million to continue the development of the California Longitudinal Pupil Achievement Data System (CalPADS) and $1.1 million to continue the development of the California Longitudinal Teacher Integrated Data Education System (CalTIDES).

To further support efforts to implement CalPADS and CalTIDES, the May Revision provides an additional $65 million one-time Proposition 98 General Fund to be allocated by the Fiscal Crisis and Management Assistance Team to school districts based on their assessment of each district's training and other pre-implementation needs. The funds would be available to schools over the next two years, which is the estimated time that the Department of Education has indicated it will take until CalPADS will be operational. In addition, $2 million is included for local staff and equipment support for the California School Information Services

(CSIS) program, which issues student identifiers. The Administration anticipates that the Department will have full implementation of CalPADS in 2008-09 which, coupled with the CSIS identifiers, will result not only in greater data reporting capability, but also efficiencies for the state and schools.

Governor's School Safety Initiative

Students learn best and achieve their full potential in safe and orderly classrooms. However, during the past decade, more than 300 school-associated violent deaths occurred on or near school campuses in America. These incidents remind us that our school systems and facilities can be vulnerable and that it is extremely important to have contingency plans and procedures in place. To address these issues, the May Revision includes a $100 million one-time block grant for a three-year pilot program to build the structure and support for providing an environment of safety for the students of California. The funding will be distributed though a competitive process to county offices of education which will then partner with K-12 schools for a variety of one-time activities including but not limited to: (1) training for safe school trainers; (2) developing immediate emergency notification systems; and (3) identifying best practices for prevention/mitigation, preparedness, response and recovery.

School Resource Officers

The Administration proposes to provide $9 million in ongoing funding to county offices of education to hire approximately 120 additional school resource officers to serve schools in jurisdictions where gang violence is prevalent. School resource officers are widely acknowledged by educators and law enforcement as a primary strategy to prevent gang violence and gang membership on school campuses. They serve as liaisons between schools and law enforcement, working with school administrators, students, parents and teachers to ensure a safe learning environment. In order to be eligible to receive funding for this program, county offices of education must work with local enforcement agencies to provide an amount equal to a 25 percent match of all funds received. The county offices of education must also conduct an in-depth survey to determine the potential statewide need for additional school resource officers.

Summer of Safety

The Administration proposes the Summer of Safety program to provide teens in neighborhoods with gang violence summer enrichment programs designed to reduce their exposure to high-risk behaviors. Specifically, the May Revision includes $2 million to a county office of education to collaborate with experienced community-based organizations that serve youth ages 11-18. This prevention program is intended to steer teens away from poor choices and towards activities such as sports; arts, music and dance; academic enrichment programs;

as well as community service projects. Activities will provide youth with opportunities to explore new interests, develop new talents and skills and find purpose in a structured and safe, day-long program. The Summer of Safety will provide summer enrichment programs for up to 5,000 teens beginning in summer of 2008.

Addressing the Teacher Shortage and Improving Teacher Quality

The May Revision proposes $50 million Proposition 98 General Fund for grants to school districts to support the hiring of more than 1,000 additional credentialed career technical education (CTE) teachers. Providing additional qualified CTE teachers is essential to ensuring that students are provided with the most relevant training and instruction to prepare them for today's workplace as well as more advanced training in community colleges and four-year institutions. As the Administration and Legislature begin to rebuild CTE programs in K-12 schools, it will be essential to provide qualified instructors to ensure those programmatic investments are ultimately successful. The Administration proposes minimum grants of $45,000 per high school and that the Department of Education, working in consultation with the Administration and Legislative Analyst, develop a methodology to determine the neediest high schools that exceed 400 students that would be eligible for this program. Priority criteria would include schools with five or fewer CTE courses at the minimum enrollment level and schools with fewer than 80 percent of CTE courses taught by instructors who are certified to teach those courses.

Fund Teachers of College Preparatory Courses—The May Revision proposes $50 million Proposition 98 General Fund to fund grants to school districts to support the hiring of additional teachers of college preparatory courses (A-G courses) in an effort to assist more students to become eligible to attend college. Availability of college preparatory courses is key to meeting eligibility requirements for the state's public university systems, and many schools lack sufficient offerings by fully qualified teachers to ensure equitable opportunities for all students. The Administration proposes minimum grants of $45,000 per high school of at least 400 or more pupils with specific eligibility criteria based on the percentage of total courses offered that qualify as college preparatory courses and the percentage of such courses taught by fully qualified teachers in those subjects.

EnCorps Teachers—The May Revision proposes to shift $10 million budgeted for the Commission on Teacher Credentialing from one-time to ongoing Proposition 98 General Fund and to increase funding by $2 million, for a total of $12 million, to establish the EnCorps Teachers Program in an effort to recruit and train experienced retirees to the teaching corps. As California continues to face a severe teacher shortage, it is crucial that we explore innovative avenues to increase the number of individuals entering the teaching profession, particularly in the subject areas of math, science and career technical education. One such untapped pool of individuals with subject matter expertise in these areas is the 11 million Californians who will retire by 2008. The EnCorps Teachers Program would establish a public-private partnership with industry and business to actively recruit retiring professionals to the classroom.

Incentives for Science and Math Teachers—The May Revision also proposes $7.5 million Proposition 98 General Fund for the Commission on Teacher Credentialing to fund a variety of incentives for existing credentialed teachers in other subject areas to become authorized to teach science and math. The Administration will work with the Commission to develop an effective incentive structure and allocation methodology for this funding.

Alternative Teacher Compensation Planning Program—The May Revision proposes $2 million Proposition 98 General Fund for a grant program to assist public school employers and exclusive representatives of credentialed teachers to plan an alternative teacher salary schedule based on criteria in addition to years of training and experience, pursuant to SB 1209 (Chapter 517, Statutes of 2006). The intent of this program is to develop alternative approaches to teacher compensation that recognize the additional efforts required of teachers to serve in challenging school settings, reward professional growth, and recognize contributions to student learning.

Personnel Management Assistance Teams—The May Revision proposes $3 million Proposition 98 General Fund to continue funding for the Personnel Management Assistance Teams pursuant to SB 1209 (Chapter 517, Statutes of 2006). These teams provide technical assistance to school districts in establishing and maintaining effective personnel management, recruitment, and hiring processes.

Administrator Training Program—The May Revision proposes $2.5 million Proposition 98 General Fund for enhancement and expansion of the Administrator Training Program. This program provides very effective training and coaching for new K-12 school principals and vice-principals on leadership skills; financial and personnel management; the interrelation between academic standards, instructional material and curriculum frameworks; and the effective use of pupil assessments. However, the current program has not been geared to adequately serve existing school administrators. The primary purpose of the additional funding is to ensure that existing school administrators receive enhanced and appropriate training and coaching that recognizes their level of expertise.

Second Grade Testing

Statutory authority for the Standardized Testing and Reporting (STAR) program exam that is used to assess student performance in the second grade will expire at the end of this year. However, second grade tests provide the only statewide assessment of whether or not a student has mastered basic reading skills. Testing in subsequent grades is focused on subject matter/content knowledge. Without second grade testing, the first information about student performance, related to state-aligned standards, would not be available until the beginning of fourth grade. Second grade testing is currently used to measure placement of students in third grade. Delaying identification of students who need additional support can be detrimental to student achievement. As a result, the Administration proposed funding to continue the second grade test and supports extending its sunset date to be aligned with the rest of the STAR components.

English Learner Supplemental Instructional Materials for After-School and Summer School Programs

The May Revision provides $20 million one-time Proposition 98 General Fund for English learner supplemental instructional materials. The funds will be available for after-school and summer school programs to help students with a primary language other than English quickly develop grade-level English language skills.

California High School Exit Exam Instructional Support

The California High School Exit Exam (CAHSEE), a cornerstone of the state's accountability system, helps to ensure that all students graduate from high school with at least the basic knowledge and skills needed in the workplace and in life. With each administration of the exam, increasing numbers of students are demonstrating their competency in reading, writing and mathematics. The CAHSEE plays a vital role in helping to identify students who are struggling so they can get the targeted assistance they need to succeed. The May Revision proposes $8.5 million for county offices of education to provide school districts with instructional assistance that will help high school students pass the CAHSEE.

Supplemental Instruction

The May Revision provides $48.1 million Proposition 98 Reversion Account to fund 2005-06 and 2006-07 Supplemental Instruction Program obligations. The program consists of four smaller programs, all of which support after-school instruction and summer school activities. Over the past few years, demand for program moneys has outpaced cost-of-living and growth adjustments provided in the annual Budget Act. Consequently, deficiencies have developed over the past few years. In order to reimburse local educational agencies for services already provided to students, the May Revision provides one-time funding that should sufficiently fund the mandatory Grades 7-12 and Grades 2-9 programs. Any remaining balances will be allocated to support discretionary program obligations.

Fiscal Crisis and Management Assistance Team Audit Funds

The May Revision provides $2 million for the Fiscal Crisis and Management Assistance Team to audit property tax revenue reporting practices at school districts and community colleges. The intent is to determine why the growth rate in property tax revenues as reported by districts is lower than the growth rates reported by the Board of Equalization and the countywide growth rates reported by county tax assessors. This discrepancy has occurred for a number of years and, for the 2005-06 fiscal year, resulted in a rate difference of approximately three percent, or $300 million. The proposed audit will determine how much property tax is being received at the district level, how those revenues are allocated, and how those revenues are reported for purposes of offsetting the state's Proposition 98 General Fund obligation.

Higher Education

The May Revision for the University of California (UC) and California State University (CSU) remains consistent with the Higher Education Compact, and includes workload adjustments to the Cal Grant program and a policy proposal to increase funding for nursing enrollments for CSU.

As discussed in the Introduction and Maximizing the Value of Public Assets sections, the Administration also proposes to privatize the Student Aid Commission's (CSAC) non-profit loan guarantee organization, EdFund, which will enable the state to receive one-time revenues estimated at $1 billion. As a consequence of this transaction, the state will resume funding for the cost of the Commission's state operations and financial aid awareness programs. This proposal will not affect the availability of low-cost student loans to California's college and university students. The Administration proposes that any sale ensure that the purchasing agency maintains the California loan guarantee function.

For the California Community Colleges (CCC), both workload and policy expenditure revisions are proposed. The changes are driven by the revised Proposition 98 guarantee for the current and budget years as discussed in the K-12 section, revised property tax revenues that are estimated to increase over the January figures in both current and budget years, and base adjustments related to enrollment declines in the CCC that have been reconciled for the current and prior years. The revised current-year guarantee and new estimates of the Proposition 98 Reversion Account provide significant one-time funding for Community Colleges totaling over $152 million, with $100 million reflected in the current year.

Overall General Fund and related Proposition 98 expenditure growth for 2007-08 for higher education increases by 5.7 percent over the current year revised level in the May Revision, as compared with the 6.4-percent growth referenced in the Governor's Budget Summary.

However, this reduced percentage is driven by increased current-year expenditures due to the additional amounts appropriated for CCC in satisfaction of the revised 2006-07 Proposition 98 guarantee. When considering that current-year funding for CCC will be available for expenditure in the budget year, the May Revision increases overall General Fund and Proposition 98-related funding for the two-year period for Higher Education by approximately $53 million.

University of California

- 2006-07 No Change
- 2007-08 No Change in General Fund

Budget Year

- A workload increase of $2 million in Proposition 99 funds is proposed to provide additional funding for tobacco-related research on a one-time basis, reflecting fund balances available from prior years.
- Trailer bill language is proposed to specify the state's intent to reinstate the employer share of future contributions to the UC retirement plan, reflecting actuarial calculations that indicate an impending shortfall within two years for the first time since the early 1990's.

California State University

- 2006-07 No Change
- 2007-08 $3.6 million General Fund

Budget Year

- $3.6 million General Fund is proposed to support an additional 340 full-time equivalent undergraduate nursing students in the budget year in recognition of overall cost pressures on the CSU and the need to continue to increase nursing enrollments.

California Student Aid Commission

- 2005-06 -$2 million General Fund
- 2006-07 -$24.3 million General Fund
- 2007-08 -$20 million General Fund

Prior Year

- Additional workload savings of $2 million is estimated for prior-year Cal Grant Program awards.

Current Year

- Workload savings of $23 million is estimated for current-year Cal Grant Program awards, reflecting lower than anticipated transfer entitlement awards and shifts of students to lower-cost institutions in the high school entitlement program.
- Workload savings of $1.3 million is estimated for current-year payments for the Assumption Program of Loans for Education (APLE).

Budget Year

The May Revision proposes a net General Fund decrease of $20 million over the level proposed in the Governor's Budget, as noted below:

- Workload savings of $42.8 million associated with revised estimates for Cal Grant Program awards that will be issued in 2007-08 based on trends noted for the current year.
- A workload increase of $2.5 million to fund revised estimates of payments for the APLE program.
- An increase of $20.3 million to shift the cost of the Commission's state operations and financial aid awareness (CalSOAP) to the General Fund in recognition of the proposed sale of EdFund, the Commission's auxiliary loan guarantee agency.

California Community Colleges

- 2006-07 $115 million net General Fund and Proposition 98 Related Sources
- 2007-08 $9 million net General Fund and Proposition 98 Related Sources

Current Year

The May Revision proposes one-time Proposition 98 General Fund policy increases of $100 million from amounts owed for the current year guarantee. These adjustments will be addressed through budget trailer bill legislation, and include:

- $50 million for career technical education equipment and associated facility reconfigurations. These funds will help ensure student access to state-of-the-art equipment necessary for developing relevant career technical skills needed in the workplace of today and tomorrow.

- $50 million for grants to colleges for equipment and other one-time uses for nursing programs in order to assist the colleges' enrollment expansion efforts in meeting the demands of the statewide nursing shortage.
- The May Revision also reflects increases in estimated property tax revenue of $15.1 million and $1.8 million in oil and mineral revenue over the January estimate that drives additional reversions of current year funds in those amounts.

Budget Year

The May Revision proposes significant ongoing budget adjustments for the CCC that will increase total General Fund and Proposition 98-related sources by a net $9 million compared to the Governor's Budget, including an increase of $5.6 million in ongoing Proposition 98 General Fund. Major ongoing Proposition 98 General Fund policy adjustments for the CCC include the following:

- Increases of $23.6 million for apportionments and $1.6 million for selected categorical programs to reflect an increase in the COLA factor from 4.04 percent to 4.53 percent.
- A base reduction of $80 million in apportionments to reflect excess current year and prior year growth funding that will revert based on the most recent enrollment information available from the Chancellor's Office. Notwithstanding this adjustment, when coupled with the 2-percent growth funding provided in the Governor's Budget, apportionment funding is sufficient to enable the system to increase full-time equivalent instructional workload by at least 3 percent over estimated current year actual workload levels.
- An increase of $10 million to the Matriculation program schedule, providing colleges with additional resources to assist students' progress towards their educational goals. This amount is coupled with modifications in the Administration's Community College Student Success Initiative to more closely align with the community college system's fall basic skills proposal.
- An increase of $500,000 for the Foster Care/Kinship Program to maintain and augment the ongoing program level.
- An increase of $1.9 million for matching grants to assist colleges with ongoing costs for establishing redundancy for the high-speed network. Redundant circuits will provide greater internet reliability during peak usage time and reduce the incidence of lost connectivity.
- An increase of $220,000 for a total proposed $570,000 for Fiscal Crisis and Management Team assistance consistent with the Chancellor's fall request to assist financially struggling districts prevent insolvency.

In addition, the following ongoing Proposition 98 workload adjustments are proposed to conform to revised estimates of local revenues and the base apportionment reduction:

- A decrease of $5.9 million that offsets an increased estimate of property tax revenues for 2007-08.
- A decrease of $1.6 million for apportionments to reflect the recalculation of 2-percent growth funding included in the Governor's Budget on a lower base, as discussed previously.
- A decrease of $1.8 million that offsets an increased estimate of student fee revenues for 2007-08.
- A decrease of $1.8 million to reflect an offsetting increase in oil and mineral revenues of an identical amount.
- An increase of $332,000 for the Board of Governor's Fee Waiver program administrative costs to reflect re-estimated student fee revenues.

The May Revision also proposes $52.7 million in one-time Proposition 98 General Fund increases from the Proposition 98 Reversion Account for the following purposes:

- $47.5 million for deferred maintenance, instructional equipment, and hazardous substance abatement, pursuant to existing match requirements. These funds will augment ongoing funding to assist colleges in core operational needs beneficial to student learning.
- $2.7 million for matching grants for one-time technology costs for establishing redundancy to ensure the delivery of high-speed internet service to all colleges.
- $2.5 million for textbook assistance for students meeting fee waiver eligibility requirements who do not receive textbook assistance under the Cooperative Agencies Resources for Education program.

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General Government

The General Government Section includes multiple departments, commissions, and offices responsible for oversight and specific activities not included in other areas. This section provides the significant issues addressed in the May Revision.

Department of Food and Agriculture

The May Revision proposes an increase of $2.0 million as a placeholder to address the Light Brown Apple Moth (LBAM) until the assessment to ascertain the areas affected by the LBAM and identify options to eradicate or control this pest is completed in mid-May. The LBAM is not native to the continental United States and has no natural enemies to control its population. More than 80 percent of the United States has a climate capable of supporting the LBAM. This pest has the potential to harm California's natural ecosystem and cause annual economic losses exceeding $100 million. Many countries list the LBAM as a Quarantine Pest. Quarantines restrict California's ability to export agricultural products, which were valued at more than $7.2 billion in 2003. The LBAM most likely entered the state through people bringing infested plants, fruits, and vegetables into California from New Zealand, Australia, or Hawaii. The Department is continuing to work with the United States Department of Agriculture to obtain federal funding.

Department of Veterans Affairs

The May Revision includes $564,000 for the Department of Veterans Affairs (CDVA) to provide salary increases to employees in job classifications affected by the Coleman and Perez court cases. These increases are necessary to properly protect and serve the members in the Veterans Homes by retaining existing staff and enhancing the recruitment of additional mental health and dental professionals. This funding will enable the CDVA to increase salaries for psychiatrists and senior psychologists to California Department of Corrections and

Rehabilitation (CDCR) salary levels less five percent, and raises salaries for all other impacted mental health and dental classifications to CDCR salary levels less 18 percent.

The May Revision proposes an augmentation of $3.3 million ($2.3 million General Fund) for the new 75-bed Alzheimer's Unit at the Veteran's Home in Yountville, expected to open in mid-July 2007. These increases include $2.3 million General Fund associated with various employee compensation costs and $1.0 million for direct patient operating and expense costs of food, pharmaceuticals, outside medical services, and supplemental medical insurance. Due to the delay in opening the Alzheimer's Unit at the California Veterans Home in Yountville from July 2006 to July 2007, the May Revision reflects 2006-07 savings of $4.0 million ($2.6 million General Fund and $1.4 million other funds).

The May Revision includes an increase of $1.2 million ($1.1 million General Fund) for a 40-bed Skilled Nursing Facility expected to open in January 2008 at the Veterans Home in Yountville. This increase includes $570,000 General Fund for various employee compensation costs and $640,000 for direct patient operating and expense costs of food, pharmaceuticals, outside medical services, and supplemental medical insurance.

Control Section 15.25—Technology Rates

The May Revision proposes a new control section authorizing the Director of Finance to adjust department budgets to reflect rate changes adopted by the Technology Services Board in January 2007 and subsequent rate changes expected to be adopted in 2007-08. The January 2007 rates reflect significant changes in how costs are recovered for central processing and telecommunications/network services to more accurately reflect actual costs. The new rates are expected to result in net savings of approximately $26.7 million statewide. Adjustments to other rates are expected in mid 2007-08. Any increases in General Fund costs to any individual department are offset by General Fund savings in other departments.

Williamson Act Subsidies

The May Revision proposes a decrease of $39.1 million General Fund associated with elimination of Williamson Act subsidies. These subsidies partially backfill property tax revenue that local governments forfeit when they enter into contracts with landowners to not develop land in exchange for reduced property tax assessments. Subsidies are funded at $5 for each acre of prime agricultural land covered by a Williamson Act contract, and $1 for each acre of non-prime agricultural land so covered.

The Administration encourages local governments to continue their Williamson Act contracts, since they help preserve agricultural land from development. However, due to the state's fiscal condition, the state cannot continue to provide funding for this program.

Recruitment for Health, Dental and Mental Health Professionals

The Governor's proposed budget includes $1 million to contract with a professional "headhunter" to assist the state in locating, recruiting, and hiring critical health care delivery staff for the departments of Mental Health (DMH), Developmental Services (DDS), Veteran's Affairs (DVA), and Corrections and Rehabilitation (CDCR). The state's compensation for medical, dental and mental health staff lags other potential employers and the state facilities that provide care for mentally ill, developmentally disabled, veterans and inmates have been unable to hire sufficient numbers of these "level-of-care" staff. Recent federal court cases involving inmate care within the CDCR have resulted in a significant increase in the number of positions and compensation disparities between the prison system and the remainder of the state's health care facilities and exacerbated the problem for other state facilities. These two factors have resulted in vacancy levels in all the institutions that place patients entrusted to the state's care at risk.

The state's usual recruiting and hiring practices have proven ineffective in locating and hiring health care staff in all the institutions. To date, each department has approached recruiting health care professionals separately and has bid against each other for the same prospects. This proposal will consolidate the recruiting and hiring efforts for the most critical classifications into a single contract. In order to facilitate the filling of these critical positions, an expedited examination and hiring process will also be implemented. It is expected that the expertise of private firms in this field will have more success than the state's traditional recruitment efforts. The Department of Personnel Administration will administer the contract with direction and oversight provided by an Advisory Council comprised of the State Personnel Board and impacted departments. It is intended that the contract provide payment to the contractor based on positions being filled rather than identifying prospects for an interview. The Administration recognizes that it may be necessary to augment this proposal should this endeavor prove successful.

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Statewide Issues

This section includes issues that affect multiple departments in various major program areas.

2007-08 State Appropriations Limit Calculation

Pursuant to Article XIIIB of the California Constitution, the 2007-08 State Appropriations Limit (SAL) is estimated to be $76.093 billion. The revised limit is the result of applying a growth factor of 5.24 percent. The revised 2007-08 limit is $86 million below the $76.179 billion estimated in January. This decrease is due to changes in the following factors:

- Per Capita Personal Income
    - January Percentage Growth: 4.58
    - May Revision Percentage Growth: 4.42
- State Civilian Population
    - January Percentage Growth: 1.24
    - May Revision Percentage Growth: 1.26
- K-14 Average Daily Attendance
    - January Percentage Growth: 0.00
    - May Revision Percentage Growth: 0.08

For SAL purposes, per capita personal income is defined as calendar fourth quarter California personal income, as estimated by the US Bureau of Economic Analysis (BEA), divided by California civilian population, estimated by the California Department of Finance. Since

BEA does not release its civilian population estimate until April, the Department of Finance uses its own estimate for the Governor's January Budget. The May Revision reflects the BEA's estimate.

The SAL for 2006-07 does not change since it was statutorily established by Control Section 12.00 of the 2006 Budget Act.

Augmentation for Employee Compensation

The Governor's Budget includes funding for salary increases required under current contract obligations for the majority of bargaining units, including Highway Patrol, safety employees, and engineers. An increase of $3.3 million from the Motor Vehicle Account is included in the May Revision for the Highway Patrol (Unit 5) based on revised estimates for the annual Highway Patrol salary survey. An increase of $15.6 million from other funds is included in the May Revision for Engineers (Unit 9) based on revised estimates for the annual engineers salary survey. General population growth accounted for increased costs for many other bargaining units and an additional $5.2 million General Fund for health care contributions. While no additional funding is included in the May Revision for Correctional Peace Officers (Unit 6), the Administration continues to bargain with the California Correctional Peace Officers Association, the exclusive representatives for this bargaining unit. Unit 6 is the only bargaining unit with an expired contract.

The Governor's Budget included an anticipated health premium increase of 12 percent, based roughly on the premium increase from the previous year. Since that time, the California Public Employees' Retirement System (CalPERS) staff has recommended increasing co-payments for office visits, emergency room visits, and prescription drugs, which would reduce the health premium increase to no more than 10 percent. The CalPERS Board has deferred action on this staff recommendation until the May 16 Board Meeting. Anticipating that the CalPERS Board will adopt staff recommendations to mitigate escalating costs, the May Revision reflects savings of $5.8 million General Fund and $7.3 million other funds associated with this recommendation.

Health and Dental Benefits for Annuitants

The Governor's Budget included an anticipated health premium increase for annuitants of 11.6 percent, based on the premium increase from the previous year. Since that time, the CalPERS staff has recommended increasing co-payments for office visits, emergency room visits, and prescription drugs, which would reduce the health premium increase to no more than 10 percent. The CalPERS Board has deferred action on this staff recommendation until the May 16 Board Meeting. Anticipating that the CalPERS Board will adopt staff recommendations to mitigate escalating costs, the May Revision reflects savings of $9.5 million General Fund associated with this recommendation.

The Government Standards Accounting Board (GASB) is requiring government employers to determine and report the long-term costs of non-pension retirement costs. The State Controller's Office contracted with the actuarial firm Gabriel, Roder, Smith, and Company to calculate the state's unfunded liability for these benefits. The Controller recently reported that the Unfunded Actuarial Accrued Liability (UAAL) is $47.88 billion if the state continues the pay-as-you-go policy and the Annual Required Contribution (ARC) is $3.59 billion beginning in 2007-08. The Controller directed the actuarial firm to assume health care increases limited to 10 percent in 2008, 9.5 percent in 2009, 9 percent in 2010, stepping down to 4.5 percent in 2017. To ensure that the Legislature and the Administration are fully informed about how the state's future annuitant health care costs will be consistent with these assumptions, the Administration is proposing Budget Act language requiring CalPERS to report its plans to control future cost increases.

Since 2000-01 the state's annual payments for retiree health and dental benefits have increased by 150 percent. This is consistent with what other public agencies in California have experienced. In response to increasing costs, the Governor, by executive order, created the Post Employment Benefits Commission to examine what is owed in unfunded pension and other post-employment benefits, and to recommend how to meet those obligations as they become due. The Commission is comprised of six Governor's appointees and six Legislative appointees. The Commission will report to the Governor and the Legislature by January 1, 2008, on the size of the liabilities for all government agencies in the state and propose a plan to address those obligations. It would be premature for the Administration to take any budget actions to address the Unfunded Actuarial Accrued Liability for these benefits until the Commission has reported to the Governor and the Legislature.

Pension Obligation Bond

Pursuant to the California Pension Restructuring Bond Act of 2004, Government Code Section 16940, et seq. (the "Restructuring Bond Act"), the state proposed to issue pension obligation bonds to make future contributions to CalPERS. The payment of the debt service on the pension obligation bonds would be payable from the General Fund.

Pursuant to the Restructuring Bond Act, the Pension Obligation Bond Committee (Committee) authorized the issuance of bonds to pay a portion of the state's pension obligation for fiscal year 2004-05 or a subsequent fiscal year. The Committee initiated a validation action seeking court determination that the bonds would not be in violation of the Constitutional debt limit because the proceeds of the bonds would be used to pay the state's employer contribution obligation to CalPERS, which is an "obligation imposed by law." The validation action was challenged in the court, and this legal challenge prevented the issuance of any pension obligation bonds in time to pay the pension contribution during either fiscal year 2004-05 or fiscal year 2005-06. The trial court ruled in November of 2005 that the proposed bonds were not valid. The Committee has appealed that decision and it is scheduled to be heard by the court of appeals this June. The Administration included pension obligation bonds in the 2007-08 proposed Governors Budget to pay a portion of the state's quarterly pension payments to CalPERS. It now appears unlikely that there will be a final, unappealable decision on the validity of the bonds in time for the pension obligation bonds to offset the state's pension contributions in 2007-08. Accordingly, the use of this funding option is being shifted from the 2007-08 fiscal year to the 2008-09 fiscal year.

The postponement of the issuance of pension obligation bonds will result in an increased General Fund need of $525 million, composed of three components: a $308 million expenditure increase, as proceeds from the bonds would have generated a direct General Fund savings; a $35 million expenditure decrease since the cost of issuance for the bonds will no longer be incurred; and a $252 million revenue reduction, as proceeds from the bonds would have been used to pay special fund obligations for pensions, with corresponding amounts transferred from special funds to the General Fund. The Committee will continue to pursue the appeal.

Public Employee Retirement System

Each year, the Board of Administration for CalPERS determines the total amount that must be paid by the state and by state employees in each retirement category. To make these determinations, CalPERS projects the actuarial cost of future benefits (referred to as the "normal cost"), as well as the unfunded liability charges for each retirement category. The Board of Administration determines the combined rate (as a percentage of salaries) employees and the state will pay for each retirement category. The employees' contributions to CalPERS are based on fixed percentages of salary that do not vary when the total amount due to CalPERS increases or decreases. The rate paid by the state, and ultimately the taxpayers, changes each year after the Board of Administration determines the normal cost and unfunded liability costs. Under the existing funding scheme, employees enjoy the security of a guaranteed benefit package without risk that they will pay more for the benefits if costs increase or investment returns lag.

While CalPERS has not yet adopted the retirement rates for 2007-08, the May Revision estimates a retirement contribution of $2.747 billion, based on the CalPERS' staff recommendation to the Benefits and Program Administration Committee of the CalPERS Board. The proposal from CalPERS' staff will result in a $1 million increase to General Fund and $23 million decrease to other funds.

Recruitment for Health, Mental Health, and Dental Professionals

The Governor's proposed budget includes $1 million to contract with a professional "headhunter" to assist the state in locating, recruiting, and hiring critical health care delivery staff for the departments of Mental Health (DMH), Developmental Services (DDS), Veteran's Affairs (DVA), and Corrections and Rehabilitation (CDCR). The state's compensation for medical, dental, and mental health staff lags other potential employers and the state facilities that provide care for mentally ill, developmentally disabled, veterans, and inmates have been unable to hire sufficient numbers of these "level-of-care" staff. Recent federal court cases involving inmate care within the CDCR have resulted in a significant increase in the number of positions and compensation disparities between the prison system and the remainder of the state's health care facilities and have exacerbated the problem for other state facilities. These two factors have resulted in vacancy levels in all the institutions that place patients entrusted to the state's care at risk.

The state's usual recruiting and hiring practices have proven ineffective in locating and hiring health care staff in all the institutions. To date, each department has approached recruiting health care professionals separately and has bid against each other for the same prospects. This proposal will consolidate the recruiting and hiring efforts for the most critical classifications into a single contract. In order to facilitate the filling of these critical positions, an expedited examination and hiring process will also be implemented. It is expected that the expertise of private firms in this field will have more success than the state's traditional recruitment efforts. The Department of Personnel Administration will administer the contract with direction and oversight provided by an Advisory Council comprised of the State Personnel Board and impacted departments. It is intended that the contract provide payment to the contractor based on positions being filled rather than identifying prospects for an interview. The Administration recognizes that it may be necessary to augment this proposal should this endeavor prove successful.

Support for the Public Employee Post-Employment Benefits Commission

On December 28, 2006, the Governor established, by Executive Order S-25-06, the Public Employee Post-Employment Benefits Commission to propose ways of addressing unfunded post-employment benefits. By January 1, 2008, the Commission must send a report to the Governor and Legislature that will:

- Identify the full amount of post-employment health care and dental benefits for which California governments are liable and which remain unfunded.
- Evaluate and compare various approaches for addressing governments' unfunded retirement health care and pension obligations.
- Propose a plan to address governments' unfunded retirement health care and pension obligations.

The Commission includes twelve members: six, including the chairperson, appointed by the Governor, three appointed by the Speaker of the Assembly, and three appointed by the Senate President Pro Tem.

For 2007-08, various state agencies will provide staff support and operating expenses to the Commission. The May Revision proposes increasing the Department of Finance's budget by $654,000 General Fund for additional support to the Commission, including contracts with an economist, health care experts, actuaries, and other staff and operating resources. The Commission will look to these experts as it determines the full amount of the liability for post-employment benefits provided by the state's public agencies and propose a plan to be considered by the state's public agencies.

Since many local agencies will not be required to disclose their UAAL for Other Post Employment Benefits until after the January 1, 2008, report to the Governor and the Legislature, funds are needed to contract for economic and actuarial modeling to identify the full amount of unfunded liabilities for all public agencies in California and to propose a plan to address these liabilities. Additional General Fund is requested to cover the costs associated with travel and per diem for Commission members and witnesses. While all other resources to support the Commission such as staff and operating expenses are to be covered by various state departments on an as-needed basis, some additional staff resources may be necessary.

Maximizing the Value of Public Assets

EdFund

The Administration proposes to sell California's student loan guarantee agency-EdFund- which would generate approximately $1 billion in one-time revenue to the state. In 1996, the Legislature authorized the California Student Aid Commission to establish a non-profit public benefit corporation to provide student loan guaranty services under the Federal Family Education Loan (FFEL) Program. Subsequently, EdFund was created in 1997 as a performance-based organization that was exempt from certain state employment and procurement requirements, which enabled it to compete with other guarantor organizations throughout the country. EdFund guarantees not only California student loans, but loans to students in other states as well. In fact, over half of all loans guaranteed by EdFund are held by non-California students. EdFund is the second largest guarantor in the nation and currently maintains a loan portfolio in excess of $27 billion.

EdFund is an inherently valuable asset because the student loan guarantee business is a fundamentally attractive financial venture. The student loan guarantee business is not a core mission or competency of government. Recognition of this fact led to spinning off the loan guarantee business from a state government operation to a quasi-governmental, private non-profit that is now EdFund. However, selling this non-governmental entity to a private company could produce a significant one-time financial benefit to the state without adversely affecting students. There are many student loan guarantee firms throughout the country that compete vigorously with each other. Nearly all of them are private firms, not governmental entities. Potential buyers of EdFund will be attracted to the opportunity of acquiring EdFund's substantial loan guarantee portfolio and brand name. In addition, potential buyers may be attracted by the indications of recent analyses that there could be significant opportunities to increase the current efficiency of EdFund and diversify into other compatible lines of business such as loan servicing and collections, thereby generating higher revenues and profit margins. The May Revision assumes that EdFund would sell for at least $1 billion. However, that gross revenue to the state would be offset by the loss of some operating revenue currently provided by EdFund to fund certain student aid activities. Consequently, the May Revision shifts this lost revenue stream of $20.3 million a year to the General Fund, resulting in a net one-time benefit to the state of approximately $980 million.

This proposal would not adversely affect students' access to loans or the interest rates they pay for loans (which are set by the federal government). EdFund does not set loan interest rates or charge students fees. Its revenues come primarily from the banks that they do business with and the federal government.

Improving the Lottery's Performance

In 1984, the voters approved the establishment of the California Lottery. Net lottery proceeds are currently used to supplement funding for education. Projected revenues of the lottery for 2007 are about $3.2 billion in sales, with approximate net proceeds to education after prize payouts and operating costs of about $1.1 billion.

Compared to the other 40 states with lotteries, California's lottery is an underperformer. Per capita average sales of all the states is $158, and the average of the ten most populous states is $190. In contrast, California's is only $81 in average per capita sales. Clearly, there is room for a greater return on the public's support of the lottery.

The Administration proposes that the Lottery be leased to a private concessionaire who could bring sales up to at least the national average, and in so doing produce a significant financial benefit to the state while holding education harmless. Various banking and investment firms have evaluated the concept in several states of turning over lottery operations to private concessionaires. Those analyses uniformly conclude that operating a state lottery would be an attractive proposition to the investment community, especially in cases like California where there is so much potential capacity to improve lottery performance. Although the estimates of the net value to the state of entering into such a concession arrangement range broadly depending upon the assumptions used, it appears clear that the value is many billions of dollars under virtually any set of assumptions. Ultimately, the market will determine the lottery's value when the state engages in a rigorous competitive process of bidding and negotiations with potential concessionaires.

The Administration is not proposing a detailed plan for utilizing lottery concession proceeds at this time. That decision is one that needs to be jointly made by the Executive and Legislative branches, and discussions on that point have not yet begun. Nevertheless, the Administration does believe that there should be two priority uses for those funds:

- First and foremost, the proceeds must be used to guarantee, at a minimum, that education receives the same dollar level of funding that it received in the highest year of lottery funding. This guarantee alone will enhance the lottery's financial benefit to education, since the lottery currently is an inconsistent provider of funding. Lottery proceeds have risen and fallen over the years, and so have not been a predictable source of funding. A basic principle of any structure for utilizing concession funding should be to guarantee a steady, more predictable funding source for education.
- Secondly, any one-time proceeds should be used to retire existing state debt. Retiring debt should be a priority because it frees up money that is currently used to pay annual debt service, thus turning a one-time funding source into a more flexible ongoing funding source.

Operating a lottery is not a part of the core mission or competency of government. It is a sales, marketing and technology business. Turning the operation of the lottery over to a private concessionaire that specializes in these activities would not only be a good business move for the state, it would be good policy, since it removes an operational distraction from the state's core mission of providing public services. However, the state would retain underlying ownership of the lottery and would continue to regulate it in the interest of public protection.

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