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.